Report of the
Auditor General of Canada
to the House of Commons

1988 Main Points

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PREFACE

This booklet is a new venture for the Office of the Auditor General. It should be seen as one piece in a continuing task. That task is to communicate clearly the results of our audits.

Our auditing only has value when we get its messages across. To Members of Parliament. To the Government. To the taxpayers of Canada who provide the dollars the Government spends.

The Auditor General's annual Report exceeds 600 pages. Of necessity, it contains much detailed information. Despite our best efforts, I recognize that it is not an easily accessible document.

Our new booklet has two purposes. First, it gives the main points from each of this year's audits. Second, the paragraph references at the end of each main point permit quick access to the information in the Report itself.

The main points here are very abbreviated. When readers have identified matters of interest to them, I urge them to go to the full Report for the complete message.

I hope that the booklet proves to be a useful and convenient tool.

Kenneth M. Dye, F.C.A.
Auditor General of Canada

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MATTERS OF SPECIAL IMPORTANCE AND INTEREST

The first chapter of his Report gives the Auditor General the opportunity of commenting on the most significant issues identified in this year's audits. (paragraph 1.1)

He begins by focussing on the study of Well-performing Organizations. He emphasizes that the study is another step in what he sees as a continuing contribution by his Office to improved productive management in the public service. (1.2 to 1.25)

Ken Dye goes on to examine two aspects of the information Parliament receives. He notes progress in the quality of the Estimates. And he presses for more scrutiny by MPs of the public debt and the cost of servicing it. (1.26 to 1.54)

In surveying this year's chapters, the Auditor General's verdict is that there seems little sense of urgency in finding solutions to problems. (1.55 to 1.70)

He then writes more fully about five issues. First, about the difficulty of ensuring that funds that flow from the federal purse to other levels and entities are spent cost-effectively and as Parliament intends. Second, about the importance of maintaining Canada's high reputation in the inspection of food products. Third, he discusses an aspect of tax collection. Fourth, he is concerned about the future of our forests. Fifth, he makes the point that information itself is a costly and valuable resource. (1.71 to 1.128)

The Auditor General next discusses several parliamentary and auditing activities that are contributing to the evolution of comprehensive auditing. (1.129 to 1.141)

A section he titles "The Numbers Have Meaning" concludes the chapter. In it he comments on some implications of "the implacable increase in Canada's burden of debt". (1.142 to 1.154)

OBSERVATIONS BY THE AUDITOR GENERAL ON THE FINANCIAL STATEMENTS OF THE GOVERNMENT OF CANADA

The Government of Canada is a world leader in providing summary financial information about its operations in audited form. However, the information is based on certain accounting policies that I believe are inappropriate and is presented in a manner that makes it difficult to understand. (paragraphs 2.1 to 2.4)

The accounting policies that I believe are inappropriate result in:

- failure to provide an allowance for at least $1.3 billion in borrowing by Crown corporations; (2.51 to 2.64)
- failure to consolidate the financial statements of Crown corporations, causing reported assets, liabilities, revenues and expenditures to be understated by significant but as yet undetermined amounts; (2.65 to 2.70)
- failure to record about $4.2 billion in liabilities related to the indexing of employee pensions. (2.71 to 2.73)

Members of Parliament and other users need financial information about the Government that is both credible and understandable. (2.5 to 2.8)

Credibility will be enhanced if the Government modifies its accounting policies to conform with recommendations of the Canadian Institute of Chartered Accountants' Public Sector Accounting and Auditing Committee. (2.9 to 2.19)

Understandability will be enhanced if the Government presents its financial statements in a comprehensive yet succinct annual financial report similar to annual reports published by corporations in the private sector. (2.20 to 2.31)

AUDIT NOTES

The Audit Notes chapter fulfils a special role in the annual Report. Other chapters normally describe the findings of the comprehensive audits we perform in particular departments. The Audit Notes chapter brings together in one place individual matters that have come to our attention during routine auditing of the Public Accounts of Canada, Crown corporations and other entities. It is also used to report some matters that have come to our attention during comprehensive audits.

Where, in the Auditor General's judgment, these matters are of significance and of a nature that they should be brought to the attention of the House of Commons, the Auditor General Act requires him to include them in his annual Report.

The Audit Notes chapter is, therefore, a compilation of these instances.

The notes relating to departments include failures to deposit moneys to the Consolidated Revenue Fund; inadequate financial controls; the non-use of a leased property, a matter that remains unresolved after 14 years; an undisclosed subsidy; circumvention of a Treasury Board decision; lack of due regard for economy; failures to collect money owed to the Government; a payment in advance of need; and a lack of control over payments to a Crown corporation. (paragraphs 3.15 to 3.73)

Two other notes relate to Crown corporations. One reports a departure from generally accepted accounting principles. In the second case, a corporation has involved itself in activities beyond its statutory powers. (3.4 to 3.14)

While the notes report matters of significance, they should not be used as a basis for drawing wider conclusions about matters we did not examine.

WELL-PERFORMING ORGANIZATIONS

We examined eight government organizations that are considered to be performing well. We sought to identify and describe the attributes that contribute to this high performance. (paragraphs 4.9 to 4.11)

Emphasis on people. People are challenged, encouraged and developed. They are given power to act and to use their judgment. There is a belief that high performance is a product of people who care rather than systems that constrain. People do not preoccupy themselves with the risk of failure, but are confident they can tackle virtually any challenge. (4.73 to 4.76)

Participative leadership. Leadership is not authoritarian or coercive, but participative whenever possible. The leaders envision an ideal organization, define purpose and goals, then articulate these and foster commitment. Staff communicate easily. They feel comfortable consulting their peers as well as those above and below them. Although formal levels exist for administrative purposes, there are no boundaries that inhibit collaboration in achieving goals. (4.77 to 4.80)

Innovative work styles. Staff reflect on their performance. They learn from the effects of their actions. They seek to solve problems creatively. They maintain strong monitoring, feedback and control systems as useful tools. They are self-reliant, rather than dependent on control from an outside authority. (4.81 to 4.84)

Strong client orientation. These organizations focus strongly on their clients, deriving satisfaction from serving the client rather than the bureaucracy. There is an alignment of values and purpose between the well-performing organizations and their political and central agency masters, with a view to strong performance and high achievement. (4.85 to 4.88)

A mindset that seeks optimum performance. People hold values that drive them to always seek improvement in their organization's performance. When conditions change, they adjust their methods, not their values. Because of this orientation toward performance and adaptability, the organization performs well even in a changing environment. This mindset may be the most important attribute of all. (4.91 to 4.96)

INFORMATION FOR PARLIAMENT

In 1981 the Government committed itself to providing Parliament, and hence the public, with improved and expanded information in the Estimates documents. These were to establish an "information base for assessing future intentions in the light of past performance and for holding the government accountable for its performance." Good progress has been made except in reporting program performance and results.

The Estimates documents are in three parts. Part III, expenditure plans for each department and agency, provides details of spending intentions and program performance. We found that these Part III documents are the best single source of information about most departmental programs. They have been improving steadily and compare favourably with the best we found in other countries. (paragraph 5.31)

Nevertheless, they are not yet a fully satisfactory basis for accountability because they cannot be easily understood by Members of Parliament and the public, and are not complete. Although they contain much valuable and relevant information, it is too hard to extract. When extracted, the information usually presents a valid picture of the program's intentions. (5.41 to 5.112)

In our opinion, three main additions would improve the understandability and accessibility of information in the Part IIIs:

- a short overview of major program components at the start of each program section, which would explain spending intentions and program performance in ordinary language;
- an index; and
- a citation of documentary sources, with these documents being made readily available to Members of Parliament. (5.35)

The Part IIIs can come significantly closer, in terms of completeness, to meeting the Government's commitment on disclosure only through improved reporting of program performance and results. But this will depend on most departments developing improved measurement and reporting systems for program performance. (5.50 to 5.56)

GROUP SURGICAL-MEDICAL INSURANCE PLAN (GSMIP)

The Group Surgical Medical Insurance Plan (GSMIP) is the largest private health insurance plan of its kind in Canada. It provides medical and hospital coverage for 400,000 employees and pensioners of the federal and territorial governments, certain Crown corporations and other entities. Annual premiums were more than $100 million in 1987. Claims paid were $85 million. Accumulated surpluses and reserves at the end of 1987 were $93 million. (paragraphs 6.2, 6.3)

Treasury Board Secretariat, in consultation with the National Joint Council which must agree with any policy and financial changes, needs to examine how effectively and efficiently GSMIP is being managed. In our opinion, there is a significant need for a thorough review of existing financial arrangements, for closer monitoring of the insurer's activities, and for the use of professional underwriting and actuarial expertise to assist in doing this. (6.14 to 6.67)

This would contribute to better premium rate setting procedures, provide opportunities for significant cost savings and improved cash flow, and help ensure more efficient claims processing. (6.14 to 6.67)

Both Treasury Board Secretariat and the insurer recognize that alternative funding arrangements would result in annual cost savings to the Plan through the reduction of premium and sales taxes. This could be as much as $2.5 million each year. (6.46, 6.47)

GSMIP has been insured by the same life insurance company since the Plan began in 1960. Given the size and importance of the Plan, Treasury Board would be well advised to go out to competitive bidding on a periodic basis – say, every five or ten years. (6.48, 6.49)

DEPARTMENT OF AGRICULTURE CANADIAN FORESTRY SERVICE

The forest industry is one of Canada's most important industries. Nationally, about one in ten jobs and 300 communities are directly dependent on the forest resource. While the industry is strong, there is increasing concern that the current level of activity cannot be sustained. The objectives of the Canadian Forestry Service are to promote and enhance the use of the forest through research and cost-shared agreements with the provinces. This year's report focusses on the management of these activities. (paragraphs 7.4 to 7.11)

The Canadian Forestry Service needs to strengthen its co-ordinating role in managing, controlling and implementing the Forest Resource Development Agreements. (7.14)

Despite the expenditures under the Forest Resource Development Agreements, the backlog of unsatisfactorily restocked forest land in Canada continues to accumulate, although at a reduced rate. (7.15)

Program planning and delivery procedures do not always ensure that funds are being spent in accordance with agreement guidelines. The Canadian Forestry Service has yet to establish a complete national data collection system to monitor and report the status of Canada's forests. (7.17 to 7.20)

The Canadian Forestry Service needs to improve its cost records for its main program activity – conducting research. (7.43)

DEPARTMENT OF AGRICULTURE FOOD PRODUCTION & INSPECTION

We were impressed by the dedication of the Food Production and Inspection Branch's management and inspection staff, and by the high regard in which the Branch is held internationally. This reputation is important for Canada's trade.

The Branch shares responsibility with industry and with provincial and other federal departments for the safety, health and wholesomeness of agricultural food products. It conducts a wide range of activities to protect the health and safety of Canadians and the viability of large sectors of Canada's food, plant and animal industries. Work remains to be done to fully determine which risks are most serious, so resources can be better concentrated where risk is greatest. (paragraph 8.2)

The Branch needs to strengthen several key inspection practices to provide reasonable assurance that human health and safety threats posed by chemical and bacterial hazards associated with food and agricultural products are prevented or removed. Although it does extensive sensory inspections, it needs to use additional laboratory testing, generally the only way of detecting these hazards. (8.26 to 8.40, 8.44 to 8.48)

Current procedures for registering and regulating pesticides need strengthening to provide reasonable assurance that all pesticide products used in Canada are effective and pose minimal or no risk to human health and the environment. (8.49 to 8.65)

There is a need to reduce shortcomings in import inspection standards and practices to reduce Canada's vulnerability to the introduction of foreign animal or plant disease. The Animal Health program has been internationally recognized for eradicating brucellosis and tuberculosis in cattle. But the Branch is not actively involved in controlling many of the plant diseases and – in recent years – animal diseases now established that may be of significance in Canada. (8.66 to 8.100)

The Branch also needs to strengthen certain export certification practices for agricultural and forestry products in accordance with requirements of the international convention (8.101 to 8.110). It also needs to improve support and training for inspectors and relations between line and supervisory staff. (8.41 to 8.43, 8.58, 8.82 and 8.83)

CANADIAN INTERNATIONAL DEVELOPMENT AGENCY

The Canadian International Development Agency (CIDA) is responsible for the largest portion of Canada's expenditures dedicated to helping less-developed countries sustain greater social and economic progress. This year's report focusses on CIDA's contracting, aid information, and Special Programs Branch contributions to non-governmental organizations. (paragraphs 9.1 to 9.4)

Contracts are an essential element in CIDA's delivery of international aid. Work performed under these contracts, however, does not consistently respond to project needs approved by CIDA and the recipient country. (9.16 to 9.34)

CIDA does not have adequate procedures to ensure that goods are purchased at prevailing market prices or that they have the required Canadian content. (9.35 to 9.42)

Monitoring of contract implementation is a required part of contract administration. CIDA has procedures to review contractor performance but these need improvement to ensure monitors are in place at the right time and produce the appropriate reports. (9.43 to 9.48)

CIDA has an Aid Information System to provide financial data and track project implementation. This system which took six years to develop, costing about $40 million, produces adequate financial information but CIDA is not achieving value for money from its project management capability. (9.49 to 9.59)

CIDA provides funds through the use of contribution agreements to Canadian and international non-governmental organizations involved in international development. Most of these organizations are implementing projects in accordance with their agreements with CIDA. (9.60 to 9.67)

CIDA's monitoring procedures are not well matched to the nature and types of non-governmental organizations receiving funds from the Special Programs Branch within CIDA. (9.68 to 9.79)

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DEPARTMENT OF ENERGY, MINES & RESOURCES – FEDERAL-PROVINCIAL CONTRIBUTION PROGRAMS

This year we reviewed three major federal-provincial contribution programs involving a variety of provinces. A contribution imposes a greater degree of accountability to Parliament than, for example, grants or other types of transfer payments. Each program we reviewed showed evidence of weak accountability to Parliament. There are inadequate plans to guide spending on individual projects, and there is very little provision for objective assessment of program results. (paragraphs 10.60 to 10.64)

Some of the projects supported by the $200 million Canada-Nova Scotia Development Fund appear to be appropriately related to the objectives of the Fund but many others – a total of more than $100 million in project commitments – do not. For example, federal money voted by Parliament to help develop offshore oil and gas resources was used to build unrelated roads, bridges and traffic light systems. Money was also spent, contrary to the terms and conditions of the Agreement, for salaries of regular provincial employees. (10.11 to 10.33)

In contrast, the projects supported by the $225 million Canada-Newfoundland Offshore Development Fund and the $63 million Mineral Development Agreements appear to be related to the broad purposes of these agreements. In the case of the Newfoundland Fund, however, virtually any type of project could be supported if the federal and provincial ministers agreed. Our main concern with the Mineral Development Agreements is that the federal government has not prepared adequate economic development plans on which they could be based. (10.34 to 10.59)

In view of the continuing importance of federal-provincial co-operation in the delivery of many programs, we believe the Treasury Board and program managers should review the problem areas we have highlighted in these programs, and take steps toward improving accountability to Parliament. (10.76, 10.77)

DEPARTMENT OF FINANCE – BORROWING PROGRAM

Gross public debt has climbed from under $40 billion at the start of the 1970s to over $325 billion today. Interest on the public debt has become the largest expenditure of the federal government. (paragraphs 11.1, 11.2)

Borrowing to meet the federal government's financial requirements is affected by environmental considerations such as volatile and unusually high real interest rates, less regulated financial markets and competitive financial institutions. To the credit of the managers of the borrowing program, these requirements have been met and an ongoing commitment to cost reduction is evident. (11.22, 11.23 and 11.55)

Development of a least-cost strategy, or base case, should be seriously considered for use as a yardstick against which the benefits and costs of alternative strategies could be evaluated. This approach would require that secondary objectives, opportunities, constraints, and risks associated with borrowing activities be clearly specified. It would also provide an important first step in evaluating the effectiveness of the borrowing program. (11.41 to 11.54)

The full relative costs of different debt instruments – savings bonds, marketable bonds and treasury bills – should be taken into account when setting the proportion to be financed through each. (11.24 to 11.30)

Cash balances are held so the government can honour its commitments as they are presented for payment. Since the government pays more on what it borrows than it earns on its deposits, the size and efficient use of cash balances are important. This, in turn, depends on accurate forecasting of cash requirements. Improved information flows on expenditures, revenues and cash balances should help to achieve further cost reductions. (11.62 to 11.69)

Parliamentarians should be better informed about the full objective of the borrowing program, the performance of borrowing and cash management operations, and the linkages of the program to fiscal, monetary and regulatory operations and the wider economy. (11.78 to 11.80)

DEPARTMENT OF FINANCE – INCOME TAX INFORMATION BURDEN

Policy initiatives implemented through the income tax system impose a significant information burden on corporate and individual tax filers, on third parties, and on the Government itself.
(paragraphs 12.13 to 12.23)

In the design of the refundable tax credits examined in this study, the Government considered on an ad hoc basis various aspects of the information burden. In general, a more structured analysis is feasible.
(12.24 to 12.32)

For the two tax measures we examined that affect corporations, the Government engaged in consultations with the private sector. One outcome of this consultation was modifications that reduced the magnitude of the information burden. (12.33 to 12.41)

We estimate that one major proposal, affecting certain corporations in their role as providers of information concerning their employees, will involve one-time costs to these corporations in the order of $330 million (1988 dollars). Approximately $170 million represents the costs for review and possible amendment of existing plans, approximately $100 million represents the costs of providing information and counselling to plan members, and approximately $60 million represents the cost of setting up systems to report information to the Department of National Revenue-Taxation. A further annual cost in the order of $15 million will be incurred to comply with reporting requirements. The ultimate incidence of these costs will depend on the corporations' ability to shift the costs to others. The Government's disclosure of the impacts of this proposal has not included an estimate of such costs. (12.14 to 12.18 and 12.37, 12.38)

DEPARTMENT OF FISHERIES & OCEANS – ATLANTIC FISHERIES

The Atlantic fisheries produce over $2.3 billion in products, export $1.9 billion, and give direct employment to over 100,000 people. The Department's mandate involves it directly in most aspects of this industry, including resource management (husbanding the resource and managing the harvest) and fish inspection (inspecting the handling, processing and storage of the product). The Department has a strong reputation internationally for both of these programs. (paragraph 13.17)

We found that the procedures used to set the annual fishing plans were reasonable. However, there is a need for improved economic analysis relating to long-term fleet viability. The long-term strategies for specific fleets and fisheries should consider the associated enforcement costs. Further, technological change and past practices have made it difficult for the Department to control fully the fishing capacity of boats used in the fishery. (13.29 to 13.52)

Problems were found in the acquistion of some capital items used in fisheries enforcement. (13.61 to 13.88) The productivity of crews on inshore patrol boats could be increased. (13.75 to 13.78)

Procedures to inspect fish products for health and safety defects were adequately controlled. However, weaknesses in management practices and controls have led to inconsistencies in the inspection practices for quality and sensory defects. (13.89 to 13.118)

The Pacific region has made progress in addressing the recommendations from our 1986 Report. Some areas require continued attention. (13.167)

Management has been aware of most of these problems, often for many years. Action has often been diverted by crises in the industry. One of the major challenges faced by departmental management will be to continue to marshall the resources and sustained will to see the solution of these problems through to a successful conclusion. (13.20)

DEPARTMENT OF INDIAN AFFAIRS AND NORTHERN DEVELOPMENT

The administration of Indian Affairs is one of the most complex areas of public administration, involving difficult historical, constitutional, federal-provincial and social issues. (paragraphs 14.1 to 14.9)

The Department of Indian Affairs and Northern Development (DIAND) does not have a clear legislative mandate for funding or delivering Post-Secondary Education Assistance and Social Development services. Thus, roles and responsibilities are unclear and there is no real accountability link between the Department and Parliament for these activities.
(14.19 to 14.27)

This absence of a clear legislative mandate has resulted in misunderstanding and uncertainty among Indians about the purpose of these activities and the services to be delivered. (14.28 to 14.31)

The Department requires a clear legislative mandate which defines the responsibilities of Canada with respect to the delivery and funding of services to Indians. Such a mandate would facilitate the negotiation of agreements between Canada, the provinces and Indian bands, and establish the accountability framework that is now missing.
(14.32 to 14.35)

The Department has improved its systems and procedures in the areas of Housing and Community Capital Facilities. (14.89, 14.90)

For over 20 years we have reported that the Department cannot assure Parliament that funding provided to bands through contribution agreements and other funding arrangements is used for its intended purposes.
(14.95 to 14.98)

There remains a fundamental need for a more practical approach to funding bands, which would include a realistic monitoring role for DIAND. (14.118 to 14.122)

Chapter 14

DEPARTMENT OF NATIONAL DEFENCE

The Munitions Supply Program was initiated in 1978 to provide the Department with an assured wartime production capability for critical ammunitions items. This production capability has not yet been identified. This has precluded DND from developing plans for achieving the strategic objective of the Munitions Supply Program and from determining how best to apply direct and indirect funding mechanisms to achieve that objective. (paragraphs 15.19 to 15.32)

The Department needs to develop a medical supply system that will provide the framework for a complete wartime capability, while also meeting peacetime needs efficiently and economically. This could be achieved by the measures recommended in our report. (15.41 to 15.49)

The Department is carrying significant amounts of ammunition stock for training above the levels authorized or required and of repairable parts that exceed peacetime requirements. It has shortages of some repairable parts. Holding inventory that exceeds requirements inflicts a cost penalty, while shortages reduce the level of operational readiness. (15.33 to 15.37, 15.60 to 15.68 and 15.104 to 15.110)

Increased management attention could be given to assessing the performance of repair contractors, carrying out audits of repair contracts, and executing warranties. (15.74 to 15.83 and 15.101 to 15.103)

The Department's Part III of the Estimates could be improved by including indicators of defence capabilities and requirements, together with indicators of peacetime performance. (15.114 to 15.118)

Revenues from rentals of married and single quarters and sales of meals are generally assessed in accordance with regulations, and are properly collected and accounted for. (15.124 to 15.130)

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DEPARTMENT OF SUPPLY AND SERVICES

In 1986-87 the Department of Supply and Services (DSS) issued some $8.8 billion of contracts for goods and services on behalf of other government departments. Independent audit of government contracts by the Audit Services Bureau, on behalf of DSS, is important to ensure that costs and profits paid to contractors are fair and reasonable. (paragraphs 16.12 to 16.19)

In our opinion, certain aspects of contract audit coverage at DSS are deficient and do not provide adequate protection to the Crown. By comparison, government contract audit coverage in the United States is much more extensive. (16.20 to 16.42)

DSS did not have key summary information on the extent of contract audit coverage or the resolution of audit findings. Consequently, senior management could not properly assess the overall costs and benefits of the contract audit activity. (16.43 to 16.46)

We noted delays in resolving some contract audit findings, and disputes resulting from broadly worded contract costing terms. Also, DSS contract auditors were not informed of the resolution of their findings. (16.47 to 16.77)

For some major Crown projects, contract audits were delayed, and DSS contract auditors did not review the procedures used by the prime contractors in awarding significant subcontracts. (16.108 to 16.119)

The Audit Services Bureau is facing human resource problems and the contract audit approaches developed in the early 1970s have not been fully updated. (16.78, 16.79)

The Department believes that its present contract audit coverage continues to provide protection to the Crown. It is currently carrying out a review which is intended to assess the scope and extent of existing audit coverage and its adequacy for the future.

Chapter 16

REVENUE CANADA-TAXATION
TAX COLLECTION

Productivity in tax collection declined by 18 percent over the past five years. A number of factors have made it more difficult to collect taxes and have had a substantial impact on productivity. In these circumstances, we examined management's efforts to operate within its environment. Subsequent to the audit, the Department responded that, according to 1987-88 figures, 1982-83 productivity levels have been restored. (paragraphs 17.7 to 17.9)

Over the last few years, management has stressed the importance of tax collection. In its continuing efforts to emphasize collection, the Department should improve its central support to managers and supervisors; broaden and refine its criteria for ranking accounts; strengthen supervisory control; and increase comprehensive monitoring of the activity. (17.16 to 17.43)

The implementation of a major shift in assigning accounts was not adequately planned. There were some deficiencies in the planning of the development of an automated system for collection. In addition, there is no comprehensive financial budget or cost accounting for this system development project. (17.52 to 17.69)

The Department has exercised reasonable efforts to collect the refundable tax on Scientific Research Tax Credits. Nevertheless, potential losses from the program are estimated at $1.2 billion. (17.82 to 17.91)

The Department's reporting of information on the collections activity in its Part III of the Estimates needs to be improved. For example, the Department did not report the outstanding balance of approximately $3 billion in refundable taxes on Scientific Research Tax Credits requiring settlement in cash payment or legal offset. The reporting of these taxes is also absent from the Public Accounts. (17.93 to 17.106)

UNEMPLOYMENT INSURANCE ACCOUNT

Since 1983, the Commission has improved its productivity in processing UI claims. Nevertheless, the variable unit costs of processing claims still varied by some 122 percent among all Canada Employment Centres (CECs) in 1987-88. Savings could result if the the least productive CECs could lower their unit costs to the national average. (paragraphs 18.13 to 18.24)

Records of employment prepared by employers are a significant source of errors. The Commission estimates overpayments and underpayments due to such errors at $76 million and $57 million respectively in 1987. (18.41 to 18.43)

With the revitalization of CECs, the Commission introduced significant improvements in some of its employment service delivery mechanisms. Their effect on operational efficiency and effectiveness will not be known until performance indicators are selected and program evaluation results are available. (18.65 to 18.71)

There were significant differences in the application of the registration policy on worker-clients. Computerized inventories of worker-clients were not always used efficiently and effectively. (18.86 to 18.92)

Insufficient co-ordination and communication between Employment and Insurance Services hindered the prompt re-employment of UI claimants. Substantial savings could be achieved if greater efforts were made to help UI claimants return to the workforce more quickly. (18.96 to 18.106)

UI claimants who meet the Commission's criteria are not systematically registered with Employment Services. This renders the worker-client inventory incomplete and reduces CECs' access to potential suitable candidates. Most CECs visited did not have an effective system of controls for UI claimants who failed to report to an employer for a job interview. (18.102 to 18.110)

At 31 March 1988, the UI Account surplus of $1.7 billion reduced the annual deficit of Canada. It would be desirable to continue to maintain a reasonable surplus position as a preventive measure. (18.120, 18.121)

SPECIAL AUDITS

Suspected Fraud Reporting Procedures
In 1984-85, we found government procedures to report suspected fraud to be inadequate. Our current audit examined the extent to which six departments were complying with subsequent Treasury Board policy directions issued in 1987. (paragraphs 19.3 to 19.6)

In our opinion, progress has not been satisfactory. Most of the six departments examined had not established the required procedures for reporting all suspected cases of fraud and other offences or for reporting violations of the Financial Administration Act (FAA) and its regulations. Also, they had not adequately informed all employees of the legal obligation under the FAA to report suspected losses of money, fraud and violations of the FAA, and how and to whom reports should be made. (19.7 to 19.13)

We were concerned that individuals would be reluctant to report for fear of reprisals and that the wide dispersal of records of cases in various branches of departments might lead to unfairly damaging innocent persons. We recommended that the identity of such individuals and all related records should be protected. (19.14 to 19.18)

In January 1988, the President of the Treasury Board asked ministers to request that management of their Crown corporations establish fraud reporting procedures and report offences to the RCMP. We plan to review the adequacy of these procedures in the future. (19.19 to 19.22)

Major Capital Projects
We examined six projects with a total cost of $250 million that represented construction activity within the federal government by various departments. In two cases, planning took from 10 to 13 years; in the third, it is still continuing after 15 years. In consequence, in one project the usable space constructed was substantially larger than planned, without supporting justification for the increase. Our concern is that needs may change over such a long period and may not be reflected in the final product. (19.31 and 19.48)

For the proposed Animal Virus Laboratory, we found insufficient justification to support the initial decision to construct – a decision withdrawn for financial reasons. Although the Animal Disease Research Institute was within the Treasury Board approved budget, there was insufficient analysis of alternatives. The Government of Canada Building in Edmonton, acquired under a lease purchase agreement, was built with deviations from the National Building Code which will affect some fire resistance and floor loading capacities. (19.43 and 19.46)

We examined lease purchase as a method of acquiring government accommodation and concluded that it is not economical compared to construction by the Crown. (19.44)

Special Air Services
Government departments often need air services not normally provided by commercial carriers. In such circumstances, they acquire them by charter, lease, lease purchase or outright purchase. (19.71, 19.72)

Seven government departments, excluding National Defence and Transport, spent $55.7 million in 1986-87 to operate 55 Crown-owned aircraft and to contract for 534 charters or leases. Current departmental regulations and directives were followed, and the use of aircraft was linked to approved program objectives. (19.73 to 19.78)

However, there are no government-wide directives relating to acquisition or management of aircraft and no uniform basis for obtaining cost information for budgeting and accounting for the use of aircraft services. (19.78 to 19.83)

We found distinct weaknesses in the planning, options analysis, pricing and availability and final definition stages of project management. The most common fault was the absence of in-depth economic analysis to support purchase, lease or charter decisions. (19.83 to 19.85)

Multiple Source Subsidies
The objective of this special audit was to assess whether there is a significant risk that projects may be funded under more than one government program without the knowledge of other donor departments or in contravention of government policies. (19.152)

Chapter 19

We reviewed 114 contributions made to 21 commercial enterprises from eight departments, and found that few projects were funded under more than one government program. However, in the case of research and development projects receiving support from more than one program, communication between donor departments was weak and the risk of double funding was present. (19.154 to 19.156)

FOLLOW-UP OF RECOMMENDATIONS IN PREVIOUS REPORTS

The follow-up chapter reports on the actions taken by departments and agencies in response to our past observations and recommendations. Overall, we give a mixed report card. In some cases considerable progress has been made. In others little has transpired.

1984 AUDIT. Our audit of the **Secretary of State** identified weaknesses in managing a project to develop a new information system for the **Canada Student Loans Program**. Early in 1987 the Program was reorganized, and the problems we identified are being resolved, with the exception of the new Student Loans Program information system, which has been delayed again for an indefinite period. (paragraphs 20.5 to 20.15)

1985 AUDITS. The **Public Service Commission** (PSC) has moved aggressively on our 20 recommendations and the 13 made by the Public Accounts Committee following three hearings on the chapter. Of the total, 23 recommendations have been implemented, 9 are being implemented and 1 is no longer applicable. (20.16 to 20.43)

Progress has been made on the majority of recommendations on the audit of **Customs Canada**. However, since several have been addressed only recently, it is premature to report on their success. (20.44 to 20.63)

The **Law Reform Commission** has acted on our recommendations on its Research Program and on project management procedures. It has implemented reasonable measures, but further improvement is required. (20.64 to 20.70)

Our audit of the **Canadian Human Rights Commission** focussed on its major activity of managing complaints from individuals. The Commission has initiated corrective action on all issues. However, the increasing number of complaints has resulted in an increase in the backlog of outstanding cases. (20.71 to 20.77)

1986 AUDITS. The **Department of Finance** has addressed many of our recommendations on **Income Tax Expenditures**. The Government disagrees with our recommendation on the need for explicit information on tax expenditure use by Crown corporations. Other issues will require further monitoring to ensure that envisaged results are achieved. (20.78 to 20.90)

The **Ministry of the Solicitor General** is taking corrective action on all issues we raised in examining the major activities of the **Correctional Service of Canada.** However, a number of significant issues are not yet fully resolved. (20.91 to 20.117)

The **Department of External Affairs** has dealt with most of our recommendations on the **Trade Function**. However, after further study on level of service, cost recovery, and post planning and monitoring, it has decided not to implement our recommendations fully at this time. The Department's position, and our own views, are set out in the chapter. (20.123 to 20.162)

Since our audit of the **Department of Insurance**, its operations have been merged with those of the Inspector General of Banks as the Office of the Superintendent of Financial Institutions. The new Office will have stronger regulatory powers. Progress has been achieved in addressing the deficiencies noted in 1986. We remain concerned about the need to strengthen the risk assessment process. (20.163 to 20.184)

Our follow-up on the **Veterans Affairs Portfolio** reveals that many of the Department's initiatives have target completion dates after 31 March 1988. We provide a preliminary assessment of progress. (20.185 to 20.189)

A special audit of **Free Publications** addressed government policies and procedures regulating them. With one exception, we found no substantial progress in controlling expenditures on free publications, as recommended in our audit. (20.190 to 20.200)

The **Energy Mines and Resources** Communications Branch is beginning to address most of the recommendations in our special audit of the **Public Communications Function**. Some progress has been made; the new publishing policy and planning procedures are steps in the right direction. (20.201 to 20.209)

Many important issues raised in our special audit of the **Department of Energy, Mines and Resources Canada Oil and Gas Lands Administration** have yet to be satisfactorily examined. (20.210 to 20.212)

As of April 1988 none of the recommendations in our audit of the **Social Sciences and Humanities Research Council** had been fully implemented. However, recent efforts to address the issues have been tangible. (20.213 to 20.230)

ORGANIZATION AND PROGRAMS OF THE OFFICE OF THE AUDITOR GENERAL

The Office's own evaluation and the results of the Study on the Cost Effectiveness of the Audit Work of the Office have been the stimuli for a reorganization of the Audit Operations Branch which is intended to produce higher quality audits without an increase in resources. (paragraphs 21.10 to 21.13)

The Office has established a separate audit group whose responsibility is strategic, operational and human resource planning, as well as co-ordination for Audit Operations. (21.16 to 21.21)

Methodology development has been given greater emphasis; the Methodology Development Committee has been restructured and has established a methodology development plan and priorities and an operational framework. (21.22 to 21.25)

The Office has developed and upgraded its use of technology in auditing and in internal communications, with an increase in the number of personal computers and in the variety of software packages used by staff. (21.28 to 21.37)

The Program Evaluation and Internal Audit Group has continued its assessment of the effectiveness and quality of the Office's audit activities and the cost-effectiveness of its management priorities and procedures. (21.40 to 21.48)

Several successful initiatives have been taken on the international level, including organizing and holding the XIIIth Conference of Commonwealth Auditors General in Ottawa and implementing INTOSAI (International Organaization of Supreme Audit Institutions) Development Initiative training projects for individual countries and groups of countries throughout the world. (21.49 to 21.69)

Improvements and innovations have been made in areas such as developing a core training curriculm for audit staff and furthering policies on official languages, employment equity and recruiting audit trainees. (21.38, 21.39 and 21.70 to 21.77)

Rapport du
# vérificateur général du Canada
à la Chambre des communes

Points saillants 1988

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AVANT-PROPOS

La brochure que voici constitue une nouveauté au Bureau du vérificateur général. Il faudrait la percevoir comme une pièce qui se rattache à une tâche permanente : celle de communiquer avec clarté les résultats de nos vérifications.

Nos travaux de vérification ne valent que dans la mesure où nous pouvons transmettre les messages que nous véhiculons. Aux députés. Au gouvernement. Aux contribuables du Canada qui versent les dollars que dépense le gouvernement.

Le Rapport annuel du vérificateur général compte plus de 600 pages. Il renferme nécessairement beaucoup d'information en détails. Nous avons beau nous efforcer de le rendre accessible, il reste qu'il ne l'est pas facilement.

Notre nouvelle brochure a deux objectifs : elle donne d'abord les points saillants de chacune des vérifications effectuées au cours de l'exercice; ensuite, les renvois qui suivent chacun des points saillants permettent au lecteur de trouver rapidement l'information dans le Rapport lui-même.

Les points saillants ci-joints sont très abrégés. Lorsque les lecteurs auront relevé des questions qui ont un certain intérêt pour eux, je leur demande instamment de consulter le Rapport pour prendre connaissance du message détaillé.

J'ose espérer que la brochure s'avérera un outil utile et pratique.

Le vérificateur général du Canada,

Kenneth M. Dye, F.C.A.

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QUESTIONS D'UNE IMPORTANCE ET D'UN INTÉRÊT PARTICULIERS

Le premier chapitre de son Rapport constitue pour le vérificateur général l'occasion de commenter les questions les plus importantes qui ressortent des vérifications effectuées au cours de cet exercice. (Paragraphe 1.1)

Il se penche d'abord sur l'étude qui porte sur les organisations performantes. Il souligne le fait que cette étude constitue un pas de plus dans ce qu'il juge être une contribution permanente du Bureau à une gestion productive améliorée au sein de la fonction publique. (1.2 à 1.25)

Ken Dye poursuit avec l'examan de deux aspects de l'information que reçoit le Parlement. Il constate que la qualité du Budget des dépenses s'est améliorée. Puis il insiste pour que les députés examinent plus à fond la dette publique et le coût du service de cette dette. (1.26 à 1.54)

Le vérificateur général conclut, après avoir parcouru les chapitres du Rapport de cette année, que l'on fait preuve de peu de sens de l'urgence pour trouver des solutions aux problèmes. (1.55 à 1.70)

Il traite ensuite plus longuement de cinq questions. En premier lieu, il fait ressortir la difficulté qu'il y a de faire en sorte que les fonds que verse le fédéral à d'autres niveaux et entités sont dépensés de façon rentable et selon l'intention du Parlement. En deuxième lieu, il souligne l'importance de maintenir la grande réputation qu'a acquise le Canada dans le domaine de l'inspection des produits alimentaires. En troisième lieu, il fait état d'un aspect du recouvrement des impôts. En quatrième lieu, il exprime des préoccupations sur l'avenir de nos forêts. En cinquième lieu, il souligne le fait que l'information représente une ressource coûteuse et de valeur.
(1.71 à 1.128)

Le vérificateur général fait ensuite état de plusieurs activités, liées au Parlement et aux travaux de vérification, qui contribuent à faire évoluer la vérification intégrée.
(1.129 à 1.141)

Une section qu'il appelle «Les chiffres ont un sens» vient clore le chapitre. Il y formule des commentaires sur certaines répercussions de «la croissance implacable du fardeau de la dette au Canada». (1.142 à 1.154)

2

OBSERVATIONS DU VÉRIFICATEUR GÉNÉRAL SUR LES ÉTATS FINANCIERS DU GOUVERNEMENT DU CANADA

Le gouvernement du Canada s'avère un chef de file à l'échelle mondiale lorsqu'il s'agit de fournir, en format vérifié, des renseignements financiers sommaires sur ses opérations. Cependant, j'estime que les données sont fondées sur certaines conventions comptables inappropriées, et qu'elles sont présentées d'une façon qui en complique la compréhension. (Paragraphes 2.1 à 2.4)

Les conventions comptables que j'estime inappropriées ont comme conséquence :

- le défaut d'établir une provision d'au moins 1,3 milliard de dollars en emprunts de la part de sociétés d'État; (2.51 à 2.64)
- le défaut de consolider les états financiers des sociétés d'État, d'où une sous-estimation des éléments d'actif et de passif et des recettes et dépenses, sous-estimation importante dont le montant n'est pas encore établi; (2.65 à 2.70)
- le défaut de comptabiliser 4,2 milliards de dollars environ au titre d'éléments de passif en rapport avec l'indexation des pensions de retraite des employés. (2.71 à 2.73)

Les députés ainsi que d'autres utilisateurs ont besoin de renseignements financiers sur le gouvernement qui soient à la fois dignes de confiance et intelligibles. (2.5 à 2.8)

Or, pour que ces renseignements soient plus dignes de confiance, il faudrait que le gouvernement modifie ses conventions comptables en fonction des recommandations du Comité sur la comptabilité et la vérification des organismes du secteur public de l'Institut canadien des comptables agréés (CCVOSP). (2.9 à 2.19)

Pour qu'ils soient intelligibles, il faudrait que le gouvernement présente ses états financiers dans un rapport annuel global, mais concis, semblable aux rapports annuels publiés par des sociétés de l'entreprise privée. (2.20 à 2.31)

NOTES DE VÉRIFICATION

Le chapitre qui traite des notes de vérification joue un rôle particulier dans le Rapport annuel. Dans les autres chapitres, nous décrivons les constatations qui découlent des vérifications intégrées que nous avons choisi de réaliser auprès de ministères donnés. Dans le chapitre des notes de vérification, nous rassemblons des questions particulières qui ont attiré notre attention au cours de nos vérifications habituelles des comptes du Canada, des sociétés d'État et d'autres entités. Il sert aussi à signaler certaines questions qui ont attiré notre attention au cours de vérifications intégrées.

En vertu de la Loi sur le vérificateur général, ce dernier doit signaler ces questions dans son Rapport annuel s'il juge qu'elles sont importantes et qu'elles doivent être portées à l'attention de la Chambre des communes.

Le chapitre sur les notes de vérification rassemble donc ces exemples.

Les notes relatives aux ministères portent sur les sujets suivants : le défaut de déposer des deniers publics au Trésor; l'exercice de contrôles financiers insatisfaisants; un terrain loué qui n'est toujours pas utilisé : une situation qui demeure non résolue après 14 ans; une subvention non déclarée; une décision du Conseil du Trésor contournée; un manque de souci d'économie; le défaut de percevoir une somme due au gouvernement fédéral; un versement prématuré; un manque de contrôle sur les versements faits à une société d'État. (Paragraphes 3.15 à 3.73)

Deux autres notes se rapportent à des sociétés d'État. La première traite d'une société qui déroge aux principes comptables généralement reconnus. L'autre traite d'une société qui s'est engagée dans des activités qui outrepassent les pouvoirs que lui octroie la loi. (3.4 à 3.14)

Bien que les notes portent sur des questions d'importance, on ne devrait pas se fonder sur elles pour tirer des conclusions plus poussées au sujet de questions qui n'ont pas été abordées.

4 LES ORGANISATIONS PERFORMANTES

Nous avons examiné huit entités gouvernementales considérées comme des organisations performantes, afin d'en déterminer les caractéristiques et de les décrire. (Paragraphes 4.9 à 4.11)

Approche axée sur les employés. Dans ces organisations, on pose des défis aux employés, tout en les encourageant et en assurant leur formation. On leur confère des pouvoirs d'agir et on les encourage à exercer leur jugement. On estime que le rendement est le fruit du travail d'employés qui se sentent concernés plutôt que de systèmes de contrôle. Le personnel ne se soucie guère des risques d'échec et se sent prêt à relever à peu près n'importe quel défi. (4.73 à 4.76)

Le leadership stimulant. Le leadership n'y a rien du pouvoir autoritaire ou coercitif, mais fait appel à la participation des employés, dans la mesure du possible. Les dirigeants ont une vision de l'organisation modèle dont ils présentent les buts aux employés, les encourageant à s'engager. La communication ne pose aucun problème. Les employés n'hésitent pas à consulter leurs collègues, peu importe leur niveau. Il existe des niveaux officiels à des fins administratives, mais aucune restriction n'est imposée concernant la collaboration en vue de l'atteinte d'objectifs organisationnels. (4.77 à 4.80)

Les styles de travail innovateurs. Les employés s'engagent dans une réflexion sur leur rendement. Ils tirent des leçons de leurs actions et s'efforcent de résoudre les problèmes de façon créative. Ils ont, en guise d'outils, des mécanismes de contrôle, de rétroaction et de suivi bien rodés. Comptant sur leurs propres moyens, ils ne dépendent pas d'une autorité externe. (4.81 à 4.84)

L'importance accordée aux clients. Ces organisations s'intéressent de près à leurs clients, plus soucieuses de leurs besoins que de servir la bureaucratie. Leurs valeurs et objectifs s'harmonisent à ceux des organismes centraux et politiques dont elles relèvent, dans le but d'atteindre un rendement élevé et de grandes réalisations. (4.85 à 4.88)

Une volonté ferme d'atteindre l'excellence. Les employés possèdent des valeurs qui les poussent à améliorer constamment le rendement de leur organisation. Lorsque les circonstances changent, ils adaptent leurs méthodes en conséquence mais conservent leurs valeurs. Grâce à cette approche, l'organisation affiche un bon rendement même dans un environnement en mutation. Cette volonté ferme est peut-être, de toutes les caractéristiques, la plus importante. (4.91 à 4.96)

Chapitre 4

L'INFORMATION DESTINÉE AU PARLEMENT

En 1981, le gouvernement fédéral s'engageait à fournir au Parlement et au grand public des données améliorées et plus nombreuses dans le Budget des dépenses. Ce document avait pour but d'établir une base de données, afin de permettre l'évaluation des intentions ultérieures à la lumière du rendement antérieur et de tenir le gouvernement imputable de son rendement. D'excellents progrès ont été réalisés, sauf en ce qui concerne les rapports sur le rendement et les résultats de programmes.

Le Budget des dépenses renferme trois parties. La partie III, le plan de dépenses de chaque ministère et organisme, fournit les détails des dépenses envisagées et décrit le rendement de programmes. Nous avons constaté que la partie III constitue la meilleure source de renseignements au sujet de la plupart des programmes ministériels. Elle s'est constamment améliorée et se compare favorablement aux meilleurs documents que nous avons trouvés dans d'autres pays. (Paragraphe 5.31)

Néanmoins, malgré ses grandes qualités, la partie III n'est pas encore entièrement satisfaisante dans le cadre de l'obligation de rendre compte, étant donné qu'elle n'est pas facilement compréhensible pour les députés ainsi que pour le grand public et qu'elle n'est pas complète. Bien qu'elle renferme une quantité d'information importante et pertinente, celle-ci est difficile à extraire. Une fois extraite, l'information présente généralement une image valable des intentions liées aux programmes. (5.41 à 5.112)

À notre avis, trois mesures s'imposeraient pour accroître la compréhension et l'accessibilité de la partie III :

- une brève vue d'ensemble des principales composantes de programmes, au début de la section réservée à chaque programme, dans le but d'expliquer, en termes simples, les dépenses prévues et le rendement du programme;
- un index;
- une citation des sources de référence, accompagnées de ces documents qui seraient mis promptement à la disposition des députés. (5.35)

Ce n'est qu'en améliorant les rapports sur le rendement et les résultats de programme que la partie III, de par son intégralité, pourra aider le gouvernement, de façon importante, afin qu'il respecte son engagement en matière de communication. Mais il faudra que la plupart des ministères mettent au point des systèmes améliorés de mesure du rendement et de rapports. (5.50 à 5.56)

LE RÉGIME D'ASSURANCE COLLECTIVE CHIRURGICALE ET MÉDICALE

Le Régime d'assurance collective chirurgicale et médicale (RACCM) est le régime d'assurance-maladie privé le plus important de sa catégorie au Canada. Il fournit une garantie médicale et hospitalisation à 400 000 employés et pensionnés du gouvernement fédéral et des territoires, de certaines sociétés d'État et d'autres entités. En 1987, les primes annuelles dépassaient les 100 millions de dollars et les réclamations réglées, 85 millions de dollars. À la fin de 1987, les excédents et les réserves accumulés s'élevaient à 93 millions. (Paragraphes 6.2, 6.3)

Il est nécessaire que le Secrétariat du Conseil du Trésor examine, en consultation avec le Conseil national mixte, qui doit donner son accord sur toutes modifications apportées à la politique et au plan financier, dans quelle mesure le RACCM est administré de façon efficace et efficiente. À notre avis, il y a un important besoin d'examiner de plus près les arrangements financiers actuels, de mieux surveiller les activités de l'assureur, et d'utiliser des actuaires et des assureurs professionnels dans l'exécution de ces tâches. (6.14 à 6.67)

Ceci favoriserait l'amélioration des procédés d'établissement des taux de primes, engendrerait des possibilités d'économies importantes ainsi qu'une amélioration de la trésorerie et aiderait à s'assurer d'un traitement plus efficient des réclamations. (6.14 à 6.67)

Le Secrétariat du Conseil du Trésor ainsi que l'assureur reconnaissent que d'autres arrangements de financement permettraient des économies annuelles pour le régime, par le biais de la réduction des primes et des taxes de ventes. Ces économies pourraient atteindre 2,5 millions de dollars chaque année. (6.46, 6.47)

Le RACCM a été assuré par la même société d'assurance-vie depuis l'entrée en vigueur du régime, en 1960. Étant donné la taille et l'importance du régime, le Conseil du Trésor serait bien avisé de demander des soumissions par concurrence, de façon périodique, disons, tous les cinq ou dix ans. (6.48, 6.49)

LE MINISTÈRE DE L'AGRICULTURE – SERVICE CANADIEN DES FORÊTS

L'industrie forestière est l'une des plus importantes au Canada. Un emploi sur dix au pays est fourni par l'exploitation des ressources forestières et 300 communautés en dépendent directement. Bien qu'il s'agisse d'une industrie forte, l'on craint de plus en plus de ne pouvoir maintenir le niveau actuel d'activité. Les objectifs du Service canadien des forêts sont de promouvoir et d'améliorer l'exploitation forestière grâce à la recherche et à des ententes à frais partagés conclues avec les provinces. Cette année, notre rapport s'attarde sur la gestion de ces activités.
(Paragraphes 7.4 à 7.11)

Le Service canadien des forêts devrait renforcer son rôle de coordination en ce qui a trait à la gestion, au contrôle et à la mise en vigueur des ententes sur le développement des ressources forestières. (7.14)

Malgré les dépenses qu'il a faites dans le cadre des ententes sur le développement des ressources forestières, l'arriéré des terres insuffisamment reboisées au Canada continue de s'accroître quoique dans une proportion moindre. (7.15)

La planification du programme et les procédés de mise en oeuvre ne permettent pas toujours d'avoir la certitude que les fonds sont utilisés en conformité avec les lignes directrices énoncées dans les ententes. Le Service canadien des forêts doit mettre sur pied un système intégral national de cueillette de données qui lui permette d'exercer une surveillance de la situation dans les forêts canadiennes et d'en faire rapport.
(7.17 à 7.20)

Le Service canadien des forêts doit améliorer ses registres comptables concernant l'activité principale de son programme, soit la recherche. (7.43)

8

LE MINISTÈRE DE L'AGRICULTURE – PRODUCTION ET INSPECTION DES ALIMENTS

Nous avons été impressionnés par la motivation du personnel de la Direction générale de la production et de l'inspection des aliments et par sa réputation sur la scène internationale, réputation qui se révèle un atout dans les échanges commerciaux du Canada.

Avec le secteur industriel et d'autres ministères fédéraux et provinciaux, la direction générale partage la responsabilité de veiller à l'innocuité, la qualité et la salubrité des produits agro-alimentaires. Elle se consacre à un large éventail d'activités en vue de protéger tant la santé que la sécurité des Canadiens ainsi que la viabilité de vastes segments des secteurs de la production alimentaire, végétale et animale du Canada. Il faut s'attacher à déterminer les risques les plus sérieux pour mieux orienter les ressources. (Paragraphe 8.2)

La direction générale doit consolider plusieurs pratiques d'inspection clés, afin de fournir l'assurance raisonnable que l'on prévient les menaces à la santé et la sécurité humaines liées aux contaminants chimiques et bactériens dans les produits agro-alimentaires. La direction générale procède à des inspections sensorielles poussées mais devrait augmenter les épreuves en laboratoire, seule méthode courante de déceler ces menaces.
(8.26 à 8.40, 8.44 à 8.48)

Les méthodes actuelles d'homologation et de réglementation des pesticides doivent être consolidées. Ainsi nous aurons l'assurance raisonnable que tous les pesticides en usage au pays sont efficaces et ne comportent qu'un risque minimal ou nul pour la santé et l'environnement. (8.49 à 8.65)

Il faut réduire les lacunes dans les normes et pratiques d'inspection des produits importés. Ainsi le Canada sera-t-il moins vulnérable à l'importation de maladies animales ou végétales exotiques. Le Programme de la santé des animaux jouit d'une renommée internationale car il a permis l'éradication de la brucellose et de la tuberculose des bovins. Mais la direction générale n'est pas fortement engagée dans la lutte contre nombre de maladies végétales et – ces dernières années – de maladies animales implantées au Canada et peut-être importantes. (8.66 à 8.100)

La direction générale doit renforcer certaines pratiques de certification des exportations pour les produits agricoles et forestiers, conformément à la convention internationale. (8.101 à 8.110) Il faut aussi améliorer l'appui aux inspecteurs, leur formation ainsi que les relations entre le personnel d'exécution et de supervision. (8.41 à 8.43, 8.58, 8.82 et 8.83)

Chapitre 8

L'AGENCE CANADIENNE DE DÉVELOPPEMENT INTERNATIONAL

L'Agence canadienne de développement international (ACDI) est responsable de la majeure partie des fonds engagés par le Canada pour aider les pays les moins avancés à progresser sur les plans social et économique. Le Rapport de cette année porte surtout sur la passation des marchés de l'ACDI, l'information sur l'aide et les contributions que verse la Direction générale des programmes spéciaux à des organisations non gouvernementales.
(Paragraphes 9.1 à 9.4)

Les contrats sont une composante essentielle de la mise en oeuvre de l'aide que l'ACDI accorde sur le plan international. Les travaux exécutés en vertu de ces contrats ne correspondent cependant pas toujours aux exigences liées aux projets approuvés par l'ACDI et le pays bénéficiaire. (9.16 à 9.34)

L'ACDI n'a pas de méthodes appropriées pour s'assurer que les biens sont achetés au prix courant du marché ou que les normes relatives au contenu canadien sont respectées.
(9.35 à 9.42)

Le contrôle de la mise en oeuvre des contrats fait partie intégrante de l'administration des marchés. L'ACDI devra améliorer ses méthodes de contrôle de l'exécution des contrats pour faire en sorte qu'il y ait des surveillants sur place au bon moment et que ceux-ci produisent les rapports voulus.
(9.43 à 9.48)

L'ACDI possède un système d'information sur l'aide qui lui fournit des données financières et qui lui permet de suivre la mise en oeuvre des projets. Le système, dont la mise au point a duré six ans, au coût d'environ 40 millions de dollars, produit de l'information financière appropriée, mais l'ACDI ne tire pas pleinement profit des possibilités du système relativement à sa gestion des projets. (9.49 à 9.59)

L'ACDI fournit, par le biais d'ententes de contributions, des fonds à des organisations non gouvernementales canadiennes et internationales qui s'occupent de développement international. La plupart de ces organisations réalisent des projets conformément à leur entente avec l'ACDI.
(9.60 à 9.67)

Les méthodes de contrôle de l'ACDI ne sont pas bien adaptées à la nature et au mode de fonctionnement des organisations non gouvernementales auxquelles la Direction générale des programmes spéciaux, au sein de l'ACDI, verse des fonds. (9.68 à 9.79)

LE MINISTÈRE DE L'ÉNERGIE, DES MINES ET DES RESSOURCES – PROGRAMMES DE CONTRIBUTION FÉDÉRAUX-PROVINCIAUX

Nous avons vérifié, cette année, trois grands programmes de contribution fédéraux-provinciaux dans lesquels sont engagées diverses provinces. Une contribution impose un degré plus élevé d'obligation de rendre compte que, par exemple, des subventions ou d'autres genres de paiements de transfert. Nous avons constaté, dans les cas examinés, que l'obligation de rendre compte devant le Parlement était faible. Les plans qui donnent des directives sur les sommes à dépenser pour chaque projet sont insuffisants et il y a peu d'évaluation objective des résultats des programmes. (Paragraphes 10.60 à 10. 64)

Certains des projets financés à l'aide du Fonds de développement Canada – Nouvelle-Écosse de 200 millions de dollars semblent avoir un lien logique avec les objectifs du Fonds, mais plusieurs autres - qui représentent, au total, des engagements de plus de 100 millions de dollars - n'en ont pas. Ainsi, des crédits votés par le Parlement pour aider à la mise en valeur des ressources pétrolières et gazières au large des côtes ont servi plutôt à la construction de routes et de ponts et à l'installation de feux de circulation. Des sommes ont également servi à payer le salaire d'employés provinciaux permanents, contrairement aux dispositions de l'accord. (10.11 à 10. 33)

Par contre, les projets financés à l'aide des 225 millions de dollars du Fonds Canada – Terre-Neuve de développement extracôtier et des 63 millions de dollars des Ententes sur le développement minéral semblent liés aux buts généraux de ces ententes. Cependant, dans le cas du Fonds Canada – Terre-Neuve, il serait possible de financer à peu près n'importe quel projet du moment qu'il y a entente entre les ministres fédéraux et provinciaux intéressés. En ce qui a trait aux Ententes sur le développement minéral, le fait que le gouvernement fédéral n'a pas établi de plans de développement économique appropriés sur lesquels pourraient se fonder ces ententes nous inquiète. (10.34 à 10.59)

Compte tenu de l'importance constante de la collaboration du gouvernement fédéral et des provinces pour la réalisation de plusieurs programmes, nous croyons que le Conseil du Trésor et les gestionnaires de programmes devraient examiner les secteurs problématiques que nous avons soulignés et prendre les mesures qui permettront d'améliorer l'obligation de rendre compte au Parlement de l'utilisation des deniers publics. (10.76, 10.77)

LE MINISTÈRE DES FINANCES - PROGRAMME D'EMPRUNT

La dette publique brute est passée de moins de 40 milliards de dollars au début des années 70 à plus de 325 milliards de nos jours. L'intérêt de la dette publique est devenu le principal poste des dépenses fédérales. (Paragraphes 11.1, 11.2)

Les emprunts nécessaires pour répondre aux besoins financiers du gouvernement fédéral sont soumis à des influences extérieures telles que des taux d'intérêt instables et exceptionnellement élevés, des marchés financiers moins réglementés et des institutions financières concurrentielles. Il est tout à l'honneur des gestionnaires du programme d'emprunt d'avoir répondu à ces exigences et de continuer, manifestement, à tenter de réduire les coûts. (11.22, 11.23 et 11.55)

On devrait sérieusement envisager l'élaboration d'une stratégie de moindre coût ou d'un cas de base à utiliser comme jalon par rapport auquel évaluer les avantages et les coûts des stratégies de rechange. Cette méthode exigerait que les objectifs, les opportunités, les contraintes et les risques secondaires liés aux activités d'emprunt soient clairement spécifiés. Elle constituerait aussi une première étape importante pour l'évaluation de l'efficacité du programme d'emprunt. (11.41 à 11.54)

Il faudrait tenir compte du coût relatif complet des divers titres d'emprunt (obligations d'épargne, obligations négociables et bons du Trésor) pour déterminer la proportion à financer par chacun. (11.24 à 11.30)

Le gouvernement maintient des dépôts pour pouvoir faire face à ses échéances. Étant donné qu'il paie un taux d'intérêt plus élevé sur l'argent emprunté que celui qu'il obtient sur les fonds en dépôt, le niveau des dépôts et leur bon emploi sont importants. Cela nécessite une prévision exacte des besoins de trésorerie. Des données améliorées sur les dépenses, les recettes et les soldes de trésorerie devraient contribuer à réduire encore davantage les coûts. (11.62 à 11.69)

Les parlementaires devraient être mieux informés des objectifs généraux du programme d'emprunt, de l'exécution des opérations d'emprunt et de gestion des dépôts, ainsi que des liens entre le programme d'emprunt et les activités fiscales, monétaires et réglementaires, ainsi que l'économie dans son ensemble. (11.78 à 11.80)

12

LE MINISTÈRE DES FINANCES – LE FARDEAU DE L'INFORMATION FISCALE

Les mesures mises en oeuvre dans le cadre du régime d'impôt direct imposent un fardeau appréciable, sur le plan de l'information à fournir, aux contribuables (entreprises ou particuliers), aux tiers et à l'administration publique. (Paragraphes 12.13 à 12.23)

Pour concevoir les crédits d'impôt remboursables examinés dans cette étude, le gouvernement a étudié de manière ponctuelle divers aspects du fardeau que représente l'information à fournir. Une analyse plus structurée est généralement possible. (12.24 à 12.32)

Dans le cas des deux mesures fiscales qui touchent les sociétés et que nous avons examinées, le gouvernement a consulté le secteur privé. Cette consultation a débouché, entre autres choses, sur des modifications qui ont allégé le fardeau de l'information. (12.33 à 12.41)

À notre avis, une importante proposition qui touche certaines sociétés au titre des renseignements à fournir au sujet de leurs employés se traduira par un coût de mise en place de l'ordre de 330 millions de dollars (en dollars de 1988) pour ces sociétés. Environ 170 millions de dollars servent à revoir et peut-être à modifier les régimes actuels, environ 100 millions de dollars à fournir des renseignements aux participants au régime et à les renseigner, et environ 60 millions de dollars à mettre sur pied des systèmes pour fournir de l'information au ministère du Revenu national, Impôt. Des frais annuels supplémentaires de 15 millions de dollars devront être engagés pour répondre aux exigences en matière de rapports. L'incidence ultime de ce coût dépendra de la capacité pour les sociétés de faire absorber les frais par d'autres. Parmi les répercussions de cette proposition, le gouvernement n'a pas inclus d'estimation de ce coût. (12.14 à 12.18, 12.37 et 12.38)

LE MINISTÈRE DES PÊCHES ET DES OCÉANS – LES PÊCHES DE L'ATLANTIQUE

Les pêches de l'Atlantique génèrent pour plus de 2,3 milliards de dollars de produits et en exportent 1,9 milliard; elles fournissent des emplois directs à plus de 100 000 personnes. En vertu de son mandat, le ministère prend une part directe à la plupart des aspects de l'industrie, notamment la gestion des ressources (gestion des ressources comme telles et de la capture) et l'inspection du poisson (inspection de la manutention, de la transformation et de l'entreposage des produits). Le ministère jouit d'une solide réputation internationale pour ces deux programmes. (Paragraphe 13.17)

Nous avons constaté que les méthodes utilisées pour établir les plans annuels de pêche sont raisonnables. Toutefois, il faut de meilleures analyses économiques relativement à la viabilité à long terme de la flotte. Les stratégies à long terme à l'égard de flottilles et de pêches particulières devraient prendre en considération les frais connexes d'application de la loi. En outre, les changements technologiques et les pratiques passées ont fait que le ministère a éprouvé beaucoup de difficultés à contrôler pleinement la capacité des bateaux utilisés pour la pêche. (13.29 à 13.52)

Nous avons relevé des problèmes dans l'acquisition de certains équipements utilisés pour l'application de la loi. (13.61 à 13.88) La productivité des équipages des patrouilleurs côtiers pourrait être améliorée. (13.75 à 13.78)

Les procédures d'inspection suivies pour assurer la salubrité et l'innocuité des produits du poisson ont été suffisamment contrôlées. Toutefois, des faiblesses dans les pratiques et les contrôles de gestion ont entraîné des manques d'uniformité dans les pratiques d'inspection de la qualité et d'inspection organoleptique. (13.89 à 13.118)

La direction de la région du Pacifique a réalisé des progrès pour ce qui est de répondre ou de donner suite aux recommandations de notre Rapport de 1986. Un certain nombre de secteurs ont encore besoin d'attention. (13.167)

La direction est consciente de la plupart de ces problèmes et, dans de nombreux cas, depuis nombre d'années. Les efforts ont souvent été réorientés à cause de crises dans l'industrie. L'un des principaux défis auxquels la direction du ministère devra faire face sera de trouver les ressources et la volonté voulues pour réussir à résoudre ces problèmes. (13.20)

14

LE MINISTÈRE DES AFFAIRES INDIENNES ET DU NORD CANADIEN

L'administration des affaires indiennes représente l'un des secteurs les plus complexes de l'administration publique car elle touche des questions ardues qui se rapportent à l'histoire, à la constitution, aux relations fédérales-provinciales et à la vie sociale. (Paragraphes 14.1 à 14.9)

Le ministère des Affaires indiennes et du Nord canadien (MAINC) ne dispose pas d'un mandat clair et précis en ce qui a trait au financement ou à la prestation de services, dans le cadre des programmes d'aide à l'éducation postsecondaire et de développement social. Il s'ensuit que son rôle et ses responsabilités ne sont pas évidents et qu'il n'est pas vraiment tenu de rendre des comptes au Parlement en ce qui concerne ces activités. (14.19 à 14.27)

Cette absence d'un mandat clair et précis a comme conséquence que les Indiens sont dans l'incertitude vis-à-vis des services offerts et ils ne comprennent pas toujours très bien l'objet de ces activités. (14.28 à 14.31)

Le ministère requiert un mandat clair et précis qui définit les responsabilités du gouvernement du Canada en ce qui concerne la prestation et le financement de services à l'intention des Indiens. Un tel mandat faciliterait la négociation d'ententes entre le gouvernement fédéral, les gouvernements provinciaux et les bandes indiennes, et permettrait de combler les lacunes en matière d'obligation de rendre compte. (14.32 à 14.35)

Le ministère a amélioré ses systèmes et procédés dans les domaines du logement et des installations communautaires. (14.89, 14.90)

Depuis plus de vingt ans, nous indiquons que le ministère n'est pas en mesure d'assurer le Parlement que les fonds versés aux bandes par le biais d'accords de contribution et d'autres modes de financement sont utilisés aux fins prévues. (14.95 à 14.98)

Il existe toujours un urgent besoin de méthodes de financement plus pratiques dans le cas des bandes. Une telle mesure comprendrait l'exercice d'un contrôle réaliste de la part du MAINC. (14.118 à 14.122)

Chapitre 14

LE MINISTÈRE DE LA DÉFENSE NATIONALE

Le Programme d'approvisionnement en munitions a été lancé en 1978, afin de garantir au ministère une capacité de production de munitions critiques en temps de guerre. Cette capacité de production n'a pas encore été établie, ce qui empêche le MDN d'élaborer des plans en vue de réaliser l'objectif stratégique du Programme et de déterminer quel est le meilleur emploi à faire des mécanismes de financement direct et indirect à cette fin. (Paragraphes 15.19 à 15.32)

Il faut que le ministère élabore un système d'approvisionnement en fournitures médicales qui serve de cadre à la constitution d'un potentiel de temps de guerre complet, tout en répondant aux besoins de temps de paix de façon efficiente et économique. On pourrait utiliser à cette fin les mesures recommandées dans notre Rapport. (15.41 à 15.49)

Le ministère possède beaucoup plus de munitions d'instruction que ce qui est autorisé ou nécessaire, ainsi que des quantités d'articles réparables qui dépassent les besoins de temps de paix. Par contre, il manque de certains autres articles réparables. D'une part, le maintien de stocks excédentaires fait augmenter les coûts et, d'autre part, les pénuries diminuent le niveau de l'état de préparation opérationnelle. (15.33 à 15.37, 15.60 à 15.68 et 15.104 à 15.110)

La direction devrait accorder une plus grande attention à l'évaluation du rendement des entrepreneurs chargés d'effectuer des réparations, à la vérification des contrats de réparation ainsi qu'au respect des garanties. (15.74 à 15.83 et 15.101 à 15.103)

La Partie III du Budget des dépenses du ministère pourrait être améliorée si l'on y ajoutait des indicateurs des besoins et des ressources militaires ainsi que des indicateurs du rendement en temps de paix. (15.114 à 15.118)

Les recettes provenant de la location des logements familiaux et des logements pour célibataires ainsi que de la vente de repas sont généralement établies conformément aux règlements et elles sont prélevées et comptabilisées correctement. (15.124 à 15.130)

LE MINISTÈRE DES APPROVISIONNEMENTS ET SERVICES

En 1986-1987, le ministère des Approvisionnements et Services (MAS) a attribué quelque 8,8 milliards de dollars en marchés de biens et services pour les différents ministères fédéraux. Pour s'assurer que les coûts défrayés et les marges bénéficiaires versées aux entrepreneurs sont justes et raisonnables, il est important que le Bureau des services de vérification (BSV) procède, au nom du ministère, à une vérification indépendante des marchés de l'État. (Paragraphes 16.12 à 16.19)

À notre avis, certains aspects de la vérification des marchés au MAS comportent des lacunes et, par conséquent, la Couronne n'est pas protégée adéquatement. En comparaison, le champ de la vérification des marchés publics aux États-Unis est beaucoup plus vaste. (16.20 à 16.42)

Le MAS n'avait pas à sa disposition d'informations sommaires clés sur l'ampleur de la vérification des marchés et sur les solutions apportées aux constatations des vérificateurs. Par conséquent, la haute direction n'a pu dûment évaluer le rapport coûts-avantages du processus de vérification des marchés. (16.43 à 16.46)

Nous avons constaté que le ministère tardait à donner suite à certaines constatations découlant de la vérification des marchés et nous avons relevé des désaccords dus à la définition trop vague des conditions contractuelles liées aux coûts. Nous avons également constaté que l'on ne tenait pas les vérificateurs des marchés du MAS au courant du suivi accordé à leurs constatations. (16.47 à 16.77)

En ce qui concerne certains grands projets de la Couronne, notre étude a révélé des retards dans la mise en oeuvre des vérifications des marchés. De plus, les vérificateurs des marchés du MAS n'ont pas étudié les méthodes qu'utilisent les entrepreneurs principaux pour attribuer les importants marchés de sous-traitance. (16.108 à 16.119)

Le Bureau des services de vérification a des problèmes dans le domaine des ressources humaines. Il n'a pas complètement mis à jour les méthodes de vérification des marchés élaborées au début des années 70. (16.78, 16.79)

Le ministère croit que l'ampleur actuelle de la vérification des marchés continue de protéger la Couronne. Il procède actuellement à un examen pour évaluer la portée et l'étendue de la vérification actuelle et sa pertinence pour l'avenir.

REVENU CANADA, IMPÔT – LE RECOUVREMENT DE L'IMPÔT

La productivité liée au recouvrement de l'impôt a diminué de 18 p. 100 au cours des cinq dernières années. Un certain nombre de facteurs ont rendu le recouvrement de l'impôt plus difficile et ont contribué sensiblement à cette diminution de la productivité. Dans ce contexte, nous avons examiné les mesures que la direction a prises pour s'acquitter de sa tâche malgré la situation. Par suite de la vérification, le ministère a répondu que les niveaux de productivité de 1982-1983 ont été restaurés d'après les chiffres de 1987-1988. (Paragraphes 17.7 à 17.9)

Au cours des dernières années, la direction a insisté sur l'importance du recouvrement de l'impôt. Dans ses efforts soutenus pour mettre l'accent sur le recouvrement, le ministère devrait améliorer l'appui de l'administration centrale aux gestionnaires et aux superviseurs; élargir et parfaire ses critères pour coter les comptes; renforcer le contrôle des superviseurs et resserrer la surveillance de l'activité de recouvrement. (17.16 à 17.43)

L'entrée en vigueur d'un réaménagement important de l'attribution des comptes n'a pas été suffisamment planifiée. Il y avait des carences dans la planification de la mise au point d'un système automatisé de recouvrement. En outre, il n'existe aucun budget financier complet ou de comptabilité analytique pour ce projet de mise au point du système. (17.52 à 17.69)

Le ministère a pris des mesures raisonnables pour recouvrer l'impôt remboursable correspondant aux crédits d'impôt pour la recherche scientifique. Néanmoins, les pertes qui pourraient éventuellement découler du programme sont estimées à 1,2 milliard de dollars. (17.82 à 17.91)

L'information du ministère destinée au Parlement au sujet de l'activité de recouvrement, que l'on retrouve dans sa partie III du Budget des dépenses, a besoin d'être améliorée. Le ministère n'a pas fait état, par exemple, du solde en souffrance d'environ trois milliards de dollars en impôt remboursable en rapport avec les crédits d'impôt pour la recherche scientifique, solde qui requiert un règlement pour un versement comptant ou une compensation légale. Les Comptes publics ne font pas état non plus de ces impôts. (17.93 à 17.106)

LE COMPTE D'ASSURANCE-CHÔMAGE

Depuis 1983, la Commission a amélioré sa productivité dans le traitement des demandes d'assurance-chômage. Cependant, les coûts variables unitaires de traitement entre tous les Centres d'emploi du Canada (CEC) varient encore de 122 p. 100 en 1987-1988. Si les CEC les moins productifs pouvaient réduire leur coût unitaire pour atteindre le coût unitaire moyen au pays, il en résulterait des économies. (Paragraphes 18.13 à 18.24)

Les relevés d'emploi (RDE), préparés par les employeurs, sont une cause importante d'erreurs. La Commission estime les trop-payés et les moins-payés dus à ces erreurs respectivement à 76 et 57 millions de dollars en 1987. (18.41 à 18.43)

La revitalisation des CEC a permis à la Commission d'améliorer grandement certains de ses mécanismes de prestation de services de placement. L'incidence globale sur l'efficience et l'efficacité des opérations ne sera pas cernée tant que les indicateurs de rendement n'auront pas été sélectionnés et que les résultats d'évaluation de programmes ne seront pas disponibles. (18.65 à 18.71)

Il existait des différences significatives dans l'application de la politique d'inscription des clients-travailleurs. Les répertoires informatisés n'étaient pas toujours utilisés de manière efficiente et efficace. (18.86 à 18.92)

Le manque de coordination et de communication entre les Services d'emploi et les Services d'assurance ne favorise pas la réembauche rapide des prestataires. La Commission pourrait réaliser des économies substantielles en déployant plus d'efforts pour que les prestataires réintègrent promptement le marché du travail. (18.96 à 18.106)

Les prestataires qui répondent aux critères de la Commission ne sont pas inscrits systématiquement aux Services d'emploi. Le répertoire des clients-travailleurs étant donc incomplet, les CEC ne peuvent rejoindre tous les candidats qualifiés. La plupart des CEC visités n'avaient pas de système de contrôles efficaces à l'égard des prestataires qui ne se présentent pas en entrevue chez l'employeur. (18.102 à 18.110)

Au 31 mars 1988, le surplus de 1,7 milliard du Compte d'assurance-chômage a réduit le déficit annuel du Canada. Il serait préférable de continuer à maintenir un surplus raisonnable à titre préventif. (18.120, 18.121)

Chapitre 18

Procédure de déclaration des actes présumés de fraude

En 1984-1985, nous avons jugé insuffisante la procédure du gouvernement pour signaler les actes présumés de fraude. Dans le cadre de notre vérification courante, nous avons essayé d'établir dans quelle mesure six ministères se conformaient aux directives émises, en 1987, par le Conseil du Trésor. (Paragraphes 19.3 à 19.6)

À notre avis, les progrès accomplis n'ont pas été satisfaisants. La plupart des six ministères que nous avons examinés n'avaient pas instauré la procédure nécessaire pour signaler tous les actes présumés de fraude et les autres types d'infractions, ainsi que pour signaler les infractions à la Loi sur l'administration financière (LAF) et à son Règlement. De plus, les ministères n'avaient pas renseigné suffisamment tous les employés sur leur obligation légale, en vertu de la LAF, de signaler les pertes d'argent, les fraudes et les infractions présumées à la LAF, ainsi que la façon de signaler ces situations et les personnes à qui il faut les signaler. (19.7 à 19.13)

Nous sommes préoccupés du fait que certaines personnes hésitent à signaler les situations susmentionnées par peur de représailles, et du fait qu'une aussi grande dispersion des dossiers des cas au sein des divers services des ministères risque de nuire à la réputation de personnes innocentes. Nous avons recommandé que l'on protège l'identité des personnes ainsi que tous les dossiers connexes. (19.14 à 19.18)

Au mois de janvier 1988, le président du Conseil du Trésor demandait aux ministres d'aviser les dirigeants des sociétés d'État d'établir une procédure en matière de déclaration des actes de fraude, et de signaler toute infraction à la GRC. Nous comptons examiner dans l'avenir la pertinence de cette procédure. (19.19 à 19.22)

Les grands projets d'immobilisations

Nous avons examiné six projets dont le coût total s'élève à 250 millions de dollars. Ces projets donnaient une bonne idée des travaux de construction entrepris au sein du gouvernement fédéral par différents ministères. Dans deux des trois cas présentés, la planification a duré de 10 à 13 ans; dans le troisième cas, elle se poursuit depuis 15 ans. Il s'en est donc suivi que dans le cas d'un projet, la superficie utile de l'immeuble construit était considérablement supérieure à celle qui avait été prévue, et aucune explication n'a été fournie pour cette augmentation. Nous craignons que les besoins aient changé au

cours d'une telle période et que l'on ne tienne pas compte de l'évolution de ces besoins dans le produit final livré.
(Paragraphes 19.31 et 19.48)

Dans le cas du laboratoire proposé de virologie animale, nous n'avons pas trouvé de résultats d'analyses sérieuses qui viennent étayer la décision initiale de faire construire – décision retirée pour des raisons financières. Bien que dans le cas de l'Institut de recherches vétérinaires, l'installation a été construite en deçà du budget approuvé par le Conseil du Trésor, il y a peu d'analyse suffisamment poussée des options de rechange. Dans le cas de la construction de l'immeuble du gouvernement du Canada, situé à Edmonton et acquis en vertu d'un bail-achat, on avait dérogé au Code national du bâtiment, et cela aura pour effet de réduire la résistance au feu et d'affecter la capacité de rangement.
(19.43 et 19.46)

Nous avons examiné la méthode de «bail-achat» pour l'acquisition d'installations du gouvernement et nous en sommes venus à la conclusion qu'il était plus économique de faire construire par l'État. (19.44)

Les services spéciaux de vol
Les ministères fédéraux ont souvent besoin de services de vol qui ne sont pas fournis habituellement par des transporteurs commerciaux. À cette fin, ils affrètent, ils louent, ils louent avec option d'achat ou ils achètent des aéronefs.
(Paragraphes 19.71, 19.72)

Sept ministères fédéraux, à l'exception de la Défense nationale et des Transports, ont consacré 55,7 millions de dollars, en 1986-1987, pour exploiter 55 appareils qui sont la propriété de l'État et 534 appareils affrétés ou loués. Les politiques et directives actuelles des ministères ont été respectées et l'utilisation des appareils pour offrir des services spéciaux de vol a été clairement liée aux objectifs officiels des programmes. (19.73 à 19.78)

Toutefois, il n'existe pour l'ensemble de l'administration fédérale ni directives régissant l'acquisition ou la gestion des aéronefs, ni méthode uniforme pour la compilation de données sur les coûts pour l'établissement des budgets, et pour rendre compte de l'utilisation des services de vol. (19.78 à 19.83)

Nous avons décelé des lacunes précises en ce qui concerne la planification, l'analyse des options, l'établissement des prix et la disponibilité, et les étapes de la définition finale en matière de gestion des projets. La lacune la plus fréquente résidait dans l'absence d'analyses économiques approfondies pour appuyer les décisions d'acheter, de louer ou d'affréter un appareil. (19.83 à 19.85).

Subventions ou contributions provenant de sources multiples
Cette vérification spéciale avait pour objet de déterminer s'il existe un risque important que des projets reçoivent des fonds provenant de plus d'un programme de l'État, sans que les autres ministères donateurs le sachent, ou en contravention des politiques du gouvernement. (Paragraphe 19.152)

Nous avons examiné 114 contributions accordées à 21 entreprises commerciales par huit ministères fédéraux, et avons constaté que peu de projets étaient subventionnés par le biais de plus d'un programme gouvernemental. Cependant, dans le cas des projets de recherche et de développement, subventionnés par le biais de plusieurs programmes, la communication entre les ministères donateurs était insuffisante, d'où le risque d'un double financement. (19.154 à 19.156)

SUIVI DES RECOMMANDATIONS FORMULÉES DANS LES RAPPORTS ANTÉRIEURS

Le chapitre sur le suivi fait état des mesures prises par les ministères et organismes fédéraux en réponse aux observations et recommandations formulées par le Bureau. Dans l'ensemble, le progrès accompli varie considérablement. Dans certains cas, des progrès importants ont été accomplis alors que dans d'autres, la situation n'a guère changé.

1984. Lors de la vérification du **Secrétariat d'État**, nous avions décelé des lacunes reliées à l'élaboration d'un nouveau système d'information concernant le **Programme canadien de prêts aux étudiants**. Au début de 1987, ce programme a été remanié et les problèmes que nous avions relevés en 1984 sont en voie d'être résolus, sauf en ce qui a trait au nouveau système d'information pour le **Programme canadien de prêts aux étudiants**, dont l'élaboration a été reportée une fois de plus et ce, pour une période indéterminée. (Paragraphes 20.5 à 20.15)

1985. La Commission de la Fonction publique (CFP) a réagi d'une façon résolue à nos 20 recommandations ainsi qu'aux 13 recommandations formulées par le Comité des comptes publics par suite de trois audiences sur le chapitre. Au total, 23 recommandations ont été appliquées, 9 sont en voie de l'être et la dernière ne s'applique plus. (20.16 à 20.43)

SUIVI DES RECOMMANDATIONS FORMULÉES DANS LES RAPPORTS ANTÉRIEURS (suite)

En ce qui concerne **Douanes Canada**, des progrès ont été réalisés pour la majorité des recommandations formulées par notre Bureau. Cependant, comme le ministère n'y a donné suite que récemment, il est encore trop tôt pour faire rapport sur le succès des mesures instaurées. (20.44 à 20.63)

La **Commission de réforme du droit du Canada** a donné suite à nos recommandations concernant son programme de recherche ainsi que ses méthodes de gestion des projets. Elle a instauré des mesures raisonnables, mais d'autres améliorations s'imposent. (20.64 à 20.70)

Notre vérification de la **Commission canadienne des droits de la personne** était axée sur sa principale activité, c'est-à-dire la gestion des plaintes déposées par des personnes. La Commission a pris des mesures correctives en rapport avec toutes les questions. Cependant, le nombre croissant de plaintes formulées a donné lieu à une augmentation des plaintes non réglées. (20.71 à 20.77)

1986. Le **ministère des Finances** a donné suite à bon nombre de nos recommandations au sujet des **dépenses fiscales**. Le gouvernement fédéral n'est pas d'accord avec notre recommandation au sujet de la nécessité d'une information explicite sur l'utilisation des dépenses fiscales par les sociétés d'État. D'autres questions devront être examinées de près pour s'assurer que les résultats escomptés sont devenus de fait une réalité. (20.78 à 20.90)

Le **ministère du Solliciteur général** est en voie de prendre des mesures en vue de régler toutes les questions que nous avons soulevées lors de notre examen des principales activités du **Service correctionnel du Canada**. Cependant, il reste un certain nombre de questions importantes à régler. (20.91 à 20.117)

Le **ministère des Affaires extérieures** a donné suite à la plupart de nos recommandations au sujet des activités liées au commerce. Cependant, après avoir examiné davantage les niveaux de service, le recouvrement des coûts, et la planification et la surveillance des missions, le ministère a décidé de ne pas mettre en oeuvre toutes nos recommandations pour le moment. Le chapitre expose la position du ministère, ainsi que la nôtre. (20.123 à 20.162)

Depuis notre vérification du **Département des assurances**, ses opérations ont été fusionnées avec celles de l'Inspecteur général des banques et il y a eu création du Bureau du surintendant des institutions financières. Le nouveau Bureau sera doté d'un plus grand pouvoir de réglementation. Des progrès ont été accomplis en vue de combler les lacunes décelées en 1986. Nous continuons cependant de nous préoccuper de la nécessité de renforcer le processus d'évaluation des risques. (20.163 à 20.184)

Dans le cas du **portefeuille des Affaires des anciens combattants**, étant donné que pour bon nombre d'initiatives, les mesures ne seront prises qu'après le 31 mars 1988, nous fournissons une évaluation préliminaire des progrès. (20.185 à 20.189)

En ce qui concerne les **publications gratuites**, nous avons examiné les politiques et la procédure qui régissent leur distribution. Sauf dans le cas d'un ministère, nous n'avons pas constaté beaucoup de progrès pour ce qui est du contrôle des dépenses afférentes aux publications gratuites, ainsi que nous l'avions recommandé. (20.190 à 20.200)

La Direction des communications du **ministère de l'Énergie, des Mines et des Ressources** commence à donner suite à la plupart de nos recommandations formulées lors de la vérification spéciale de la **gestion des communications avec le public**. La politique d'édition et les nouveaux procédés de planification constituent des pas dans la bonne voie. (20.201 à 20.209)

Il reste à examiner de nombreuses questions importantes soulevées lors de notre vérification de l'**Administration du pétrole et du gaz des Terres du Canada** du **ministère de l'Énergie, des Mines et des Ressources**. (20.210 à 20.212)

Au mois d'avril 1988, aucune de nos recommandations formulées lors de notre vérification du **Conseil de recherches en sciences humaines** n'avait été entièrement mise en application. Cependant, le Conseil a récemment déployé des efforts concrets pour donner suite à nos recommandations. (20.213 à 20.230)

Chapitre 21

ORGANISATION ET PROGRAMMES DU BUREAU DU VÉRIFICATEUR GÉNÉRAL

L'évaluation qu'a faite le Bureau de ses propres programmes et activités et les résultats de l'Étude sur le rapport coût-efficacité des travaux de vérification l'ont incité à restructurer la Direction générale des opérations de vérification; cette restructuration a pour but d'obtenir des vérifications de plus grande qualité sans qu'il soit nécessaire d'augmenter les ressources. (Paragraphes 21.10 à 21.13)

Le Bureau a créé une direction distincte de vérification qui est chargée de la planification stratégique et opérationnelle et de la planification des ressources humaines, ainsi que de la coordination au sein de la Direction générale des opérations de vérification. (21.16 à 21.21)

On a mis davantage l'accent sur l'élaboration des méthodes; il y a eu restructuration du Comité d'élaboration des méthodes et celui-ci a établi un plan, fixé des priorités et élaboré un cadre opérationnel pour l'élaboration des méthodes. (21.22 à 21.25)

Le Bureau a poussé et amélioré l'utilisation de la technologie dans les domaines de la vérification et des communications internes : il a accru le nombre des ordinateurs personnels et il offre aux employés une plus grande variété de progiciels. (21.28 à 21.37)

La Direction de l'évaluation des programmes et de la vérification interne a poursuivi son évaluation de l'efficacité et de la qualité des activités de vérification du Bureau et de la rentabilité de ses priorités et méthodes en matière de gestion. (21.40 à 21.48)

Sur le plan international, le Bureau a entrepris plusieurs initiatives couronnées de succès; il a notamment organisé la XIII^e Conférence des vérificateurs généraux du Commonwealth et a mis en oeuvre des projets pour le compte de divers pays et groupes de pays de par le monde, entre autres, plusieurs projets de formation dans le cadre du programme de l'Initiative de développement de l'INTOSAI (Organisation internationale des institutions supérieures de contrôle des finances publiques). (21.49 à 21.69)

Le Bureau a apporté des améliorations et des innovations dans des secteurs comme les programmes réguliers de formation, les langues officielles, l'équité en matière d'emploi et le recrutement des stagiaires en vérification. (21.38, 21.39 et 21.70 à 21.77)

Report of the
Auditor General of Canada
to the House of Commons

Fiscal Year Ended 31 March 1988

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AUDITOR GENERAL OF CANADA
VÉRIFICATEUR GÉNÉRAL DU CANADA

To The Honourable the Speaker of the House of Commons:

I have the honour to transmit herewith my Report to the House of Commons for the fiscal year ended 31 March 1988, to be laid before the House in accordance with the provisions of section 7(3) of the Auditor General Act, S.C. 1976-77, c. 34.

Kenneth M. Dye, F.C.A.
Auditor General of Canada

OTTAWA, 25 October 1988

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INTRODUCTION

REPORT OF THE AUDITOR GENERAL TO THE HOUSE OF COMMONS FOR THE FISCAL YEAR ENDED 31 MARCH 1988

INTRODUCTION

The principal functions and responsibilities of the Auditor General of Canada are set out in the Auditor General Act, S.C. 1976-77, c. 34, which came into force 1 August 1977. My responsibilities in respect to those Crown corporations for which I have been appointed auditor are set out in the Financial Administration Act, R.S.C. 1970, c. F-10 (amended). The Auditor General Act is included as Appendix A to this Report and the relevant sections of the Financial Administration Act as Appendix B.

The financial statements of the Government of Canada for the fiscal year ended 31 March 1988, which have been prepared by the Receiver General for Canada in accordance with the provisions of section 55 of the Financial Administration Act and appear in Volume I of the Public Accounts of Canada, have been examined by me as required by section 6 of the Auditor General Act.

In compliance with section 7 of the Auditor General Act, my Report for the fiscal year ended 31 March 1988 is presented herewith.

As auditor of the accounts of Canada, including those relating to the Consolidated Revenue Fund, I conducted such examinations and inquiries as I considered necessary to enable me to report as required by the Auditor General Act.

Departments and agencies and the Privy Council Office provided my Office with the information and explanations required to date, including Cabinet documents.

My examination of the acquisition of Petrofina Canada Inc. by the Government of Canada for at least $1.7 billion remains incomplete. The Trial Division of the Federal Court ruled that my Office was entitled to the information we requested. The majority of the Court of Appeal reversed the decision of the Federal Court. The matter is now before the Supreme Court of Canada.

MATTERS OF SPECIAL IMPORTANCE AND INTEREST

MATTERS OF SPECIAL IMPORTANCE AND INTEREST

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MATTERS OF SPECIAL IMPORTANCE AND INTEREST

1.1 This, my eighth annual Report to the House of Commons, focusses on issues that are important to every Member of Parliament. Important for all Canadians. They include the quality of information Members of Parliament receive to make their decisions; the implications of the reality that Canada must borrow money both to pay for the programs of government and to service our nation's debt; and the continuing urgent need to achieve economy, efficiency and effectiveness in delivering government services.

Well-performing Organizations

1.2 However, to begin, I wish to touch on another subject, closely related to the need to achieve value for money in the expenditure of taxpayers' dollars. It is the issue of productive management. And it allows me to begin my Report on a positive note.

1.3 There was a time when each Report of the Auditor General was anticipated as an annual opportunity for the media and the public to react with indignation or despair to its litany of horror stories.

1.4 But, for at least four reasons, such an approach seems to me incomplete and unfair. First, in so huge a complex of operations as the Government of Canada, it's only too easy to produce a yearly catalogue of deficiencies. Second, the Auditor General Act requires me to focus on shortcomings in the Government's performance, which tends to bias my reports toward the negative. Third, when public servants seem sometimes to neglect an obvious path to greater economy or efficiency, I am well aware that the Government itself may have policy reasons for imposing its own choice in the matter. Governments have many bottom lines to meet. These include economy and efficiency; but they also include such things as achieving equity, overcoming regional disparities, and injecting public money into targeted industries. I take no joy in reporting that a department has given insufficient regard to value-for-money considerations when, in fact, it was directed to act as it did. Fourth, any fair-minded observer must recognize that it is no easy task for governments to provide the immense and elaborate network of services that today's electorate demands. There will be errors. There will be inefficiencies. But in so large an organization there will also always be a place for imaginative new approaches.

1.5 However, to try something new is to invite risk. The initiative may fail. And that failure may end up in the Auditor General's Report. I am well aware that there are public servants who may shy away from a new way of doing things for that very reason.

1.6 I have done my best to reduce these fears. Our auditors are encouraged to report new approaches to solving problems. I have written of the need for public servants to develop a greater spirit of entrepreneurship. I believe that an entrepreneurial public service would be good for Canada.

1.7 My 1983 Report included a study titled Constraints to Productive Management in the Public Service that sought to explore the difficult and complex problems of managing effectively within our bureaucratic structures. The study generated widespread interest and, directly and indirectly, has contributed to a number of new initiatives.

1.8 **Ministerial authority and accountability**. The most important of these will likely prove to be Increased Ministerial Authority and Accountability (IMAA) whose aim is to give departments greater responsibility and flexibility in the use of resources. In the words of Mr. John L. (Jack) Manion, Associate Secretary to the Cabinet and Deputy Clerk of the Privy Council, who is also Principal of the Government's new Canadian Centre for Management Studies:

> IMAA (means that) instead of being hemmed in by a lot of transaction controls, managers will know in advance what they are supposed to achieve, what the broad rules of the road are and that, at the end of the road, they will be held accountable for how they use their resources to achieve their objectives.

And, significantly, he adds these words:

> IMAA requires managers who know what business they are in, who understand how to carry out that business, who share a relatively common set of values and who can be turned loose to do their job.

1.9 This closely parallels the findings of our own 1987 Financial Management and Control Study which concluded that, while it is vital to good management that managers be held accountable, it is equally important that they be held to account in ways that are meaningful and constructive.

1.10 Our 1983 study had recognized that certain managers, through innovation and personal leadership, were more successful than others in achieving results.

1.11 **A new study**. In terms both of the Government's new initiatives – specifically IMAA – and of my own mandate as Auditor General to help ensure that public moneys are spent wisely and effectively, the time seemed right to examine some of those government organizations that are perceived to be delivering their programs productively. Therefore, in early 1987, I initiated a new study whose focus was a small number of organizations in the federal government that, based on peer consensus, have acquired a reputation for performing well.

1.12 My hope was that we might be able to identify significant attributes common to these organizations, which we could then document and commend to other federal departments and agencies.

1.13 The results of our study are published as Chapter 4 of this Report: Well-Performing Organizations.

1.14 The chapter, which I urge readers to examine carefully, can be viewed as something of a follow-up to our five-year-old 'Constraints' study. That study suggested that the Government should demonstrate a strong interest in productive management; should explain and set examples of what kind of management is expected; and should help to enhance an *esprit de corps* among managers and a greater sense of responsibility for the stewardship of taxpayers' money.

1.15 The same and parallel issues are investigated in our new study, which examines eight diverse well-performing organizations in government. What our study reveals is that each of these organizations has been able to move 'beyond bureaucracy'. From its first use, the word 'bureaucracy' has had not only the neutral meaning of a body of officials in government, but also the pejorative connotation of an administration characterized by excessive red tape, prescribed procedures and controls.

1.16 In reporting that the well-performing organizations that it surveyed have moved beyond bureaucracy, our study is not at all saying that they have broken or even stretched the Government's necessarily centralized regulations. But by focussing on their people and their aspirations rather than on process, and by recognizing that commitment is more vital than control, these organizations are considered to be performing well despite the multiple constraints imposed by government policies and procedures.

1.17 **Twelve attributes**. Our study identifies 12 attributes common to the well-performing public service organizations analyzed. And it attempts to seek out the underlying factors that contribute to the development and maintenance of these attributes.

1.18 Now, I predict that there will be a number of different reactions to our new study. There will be those who label the identified attributes as 'motherhood' qualities that any good organization can be deemed to possess. Others will see the study as merely echoing the current penchant for attempting to identify management excellence – the theme of a library of books and magazine articles through the 1980s. Yet others will murmur – as they did with the 'Constraints' study – that such inquiries are not the territory of the Auditor General. And some will suggest that we are looking at the wrong side of the coin; that the real issue is not why eight organizations in the Government appear to be achieving high potential, but why so many others are not.

1.19 **Two Issues**. But my hope is that the majority who read the chapter will recognize that it is a constructive attempt to come to grips with at least two intractable issues. The first is one I referred to earlier. How can a department achieve optimum performance, and know that it has achieved it, when the bottom lines it must meet are so diverse? Our audit of the Atlantic Fisheries (reported in Chapter 13) is a reminder of this reality. The Department of Fisheries and Oceans has to be constantly aware that not only must fish be caught, processed and marketed, but also that stocks must be maintained for future generations. All the while the industry is of absolute importance in sustaining the economy of Atlantic Canada, and a vital factor in successive governments' goal of achieving regional equity. With such disparate objectives, measuring the Department's accomplishments becomes extremely difficult. I believe that it can be done and must be done. But it's no easy task.

1.20 The second issue brings into focus the centralized nature of all bureaucracies. It is necessary, for example, to have uniform rules and procedures throughout government departments. It is also necessary to ensure that departments are accountable not only to their ministers, and through them to Parliament, but also to central agencies. In addition, each department's programs must be in harmony with the Government's overall policies. The sum of all these accountabilities inevitably means that senior managers spend a great deal of time in serving bureaucratic systems. It also means that they have little time or energy left over to achieve the public sector entrepreneurship espoused in our study.

1.21 But despite all such constraints, as our survey of the eight organizations reveals, high performance – even excellence – is attainable. And the study goes some distance toward identifying how such strong performance is acquired and maintained.

1.22 **Other initiatives.** Our study has not taken place in a vacuum. There are other promising initiatives. I have already made reference to Increased Ministerial Authority and Accountability. Its objectives of eliminating levels of bureaucratic process and of giving senior managers more responsibilities, and the tools to exercise those responsibilities, closely parallel the findings of our own study. Another promising undertaking is the creation of the new Canadian Centre for Management Studies. Its goals of developing the knowledge and skills of individual managers, of developing a service ethic in the management category as a whole, of researching practical solutions to real problems in contemporary Canadian public administration, and of advancing the Government's commitment to excellence in public sector management, also demand the traits singled out in our study. As well, the Centre's objectives respond to concerns identified in our audit of the Management Category reported in my 1987 Report. I would welcome the new Centre's using our examinations of the eight organizations in our survey as potential case studies in their courses for senior management. A third, and very important endeavour, is Mr. Gordon Osbaldeston's current study of accountability in the federal public service. As I write, his final report has not yet been published.

1.23 These initiatives, together with our own study, hold promise of improved management performance throughout the public service. Perhaps one target that can be established is a minimum tenure for a deputy minister in a department. Three years would be a beginning. Five might be better still. Perhaps we can also lay to rest the half-truth that intelligent and experienced deputy ministers can manage any department regardless of its nature or service. Maybe they can. But I am convinced that they can manage far more effectively if they have had the opportunity to intimately and deeply experience and identify with the work, traditions and objectives of their departments.

1.24 Experience and knowledge generate commitment, that intangible value that our study found to be so vital in a well-performing organization.

1.25 **Next: values and ethics.** My next step in what I hope is a continuing contribution to improving productive management in the public service will be to examine in more depth the leadership qualities, values and ethics that provide so important a dimension in the best organizations. I shall be reporting on these matters within the next two years.

Information for Parliament

1.26 One of my continuing concerns as Auditor General has been to ensure that Members of Parliament receive clear, accurate and complete information: information they need both when approving expenditure plans and when holding departments accountable for their use of public money.

1.27 In past Reports I have emphasized the need to improve the relevance and usefulness of the information provided in the Financial Statements of the Government of Canada. I have also noted that Parliament receives inadequate information when tax expenditures are used to deliver programs. And I have underscored the need for details on both the intent and the actual performance of programs.

1.28 This year's Report includes a chapter (Chapter 5) that examines the information contained in the Estimates documents.

1.29 Recent years have seen a sustained commitment by the Government toward improving the information that Members of Parliament receive. The major concentration has been on enhancing the quality of the Estimates, especially the Part IIIs which spell out in detail departmental spending plans and performance.

1.30 Our chapter's main focus is on the Part IIIs.

1.31 **Part I of the Estimates.** However, first our audit raises a concern about Part I, the Government Expenditure Plan. Since 1983, for reasons explained in the chapter, information about the level of government spending, its distribution among policy areas, and the description of government plans, policy objectives and initiatives, have been reported partly in the Estimates and partly in the Budget Papers, specifically in the Fiscal Plan.

1.32 But even when these documents are looked at together, they do not describe the full context and implications of major spending initiatives over a five-year planning period.

1.33 Toward the end of this chapter, I emphasize the importance of Members of Parliament taking into account the long-term implications of their decisions. Clear and complete disclosure, in Part I of the Estimates, of the Government's overall intentions is of first importance.

1.34 **Progress with Part IIIs.** Our review of the Part IIIs reveals that very useful progress has been made. The aim of the Part IIIs is to provide MPs with summary information on how departments intend to spend the moneys presently being requested from Parliament, and how they have used the moneys previously appropriated. A Part III is therefore about both intentions and performance.

1.35 Our study shows that, since Part IIIs were introduced in the early 1980s, the quality and completeness of the information in them have steadily improved. They compare favourably with the best parallel attempts in other countries. However, there is room for further development toward greater clarity and accessibility; and information on the performance and results of programs remains inadequate.

1.36 **Part IIIs should be signposts.** What may well lie at the heart of these continuing problems is the very nature of summary information. The risk is of including either too little or too much. If a Part III provides too full a description of programs, it tends to lose its value as an overview. Yet however full the summary description, it cannot provide the details a Member of Parliament may wish to know about a specific program or – even more likely – one particular aspect of a program.

1.37 I believe that those involved in improving the usefulness of the Part IIIs should take very seriously the recommendation in our chapter that relevant documents that lie behind them should be clearly signposted in the Part III; and be readily available to Members of Parliament, their staff, and their researchers.

1.38 Ideally – and surely this is becoming more practical in these days – this detailed information could be stored in a data bank accessible by the personal computer systems now provided for each Member. It would be feasible to include in such a data bank a breakdown of the Estimates for a department showing in detail how the dollars are allocated within particular programs; for example, how much money is to be distributed to a specific segment of the population. It is precisely this kind of information, surely, that a Member of Parliament wants and needs to know.

1.39 The introduction of the Part IIIs was an important step in providing better information for Parliament. The Part IIIs themselves show steady improvement. I hope our study will contribute to their becoming even more useful to Members of Parliament.

Debt Management

1.40 There is another issue that relates to this whole question of improving the quality of information that Members of Parliament receive.

1.41 **Deficit and debt.** In Chapter 1 of last year's Report, I wrote about the federal deficit. I pointed out that relatively modest improvements in financial management and control could, over a period of time, result in significant reductions in the Government's outstanding debt. I also remarked that the federal deficit represents one of the most visible symbols of government financial performance; but that Members of Parliament received very little of the kind of information needed on which to base their understanding of the reasons for federal deficits and their downstream implications. I observed that public debt charges now represent almost one-fourth of federal government expenditure; and promised to include in my 1988 Report an examination of the debt management process, to assess whether it is being carried out with due regard to economy and efficiency.

1.42 **Managing debt is more than managing the borrowing program.** Chapter 11 reports our study of the management of the borrowing program. However, in my view, debt management has much broader implications than how the borrowing program is carried out. Indeed, our examination of the management of the borrowing program reinforces my judgment of last year that Parliament receives insufficient information and analysis of the public debt and deficits, and has insufficient opportunity for discussion and examination of their significance.

1.43 In my 1987 Report I tried to provide an account, in plain language, of the way economists look at and analyze debt and deficit issues. A distinction that I did not make in last year's discussion has to do with the way the net benefits of government expenditure programs are evaluated.

1.44 **Long-term financing.** There are activities that can be shown to yield a rate of return that exceeds both their actual cost and the interest costs on moneys borrowed to fund them. Such expenditures can carry the debt that is employed to finance them.

1.45 Many government programs are of an investment character, not just in structures and equipment, but in human potential such as education and technical training. If cost-benefit analyses were available to Members of Parliament on all government expenditure programs, they could make more informed judgments as to which are in the nature of long-term investments of benefit to future generations, and therefore more readily justify financing by debt. These could be distinguished from programs more appropriately financed through current tax revenues.

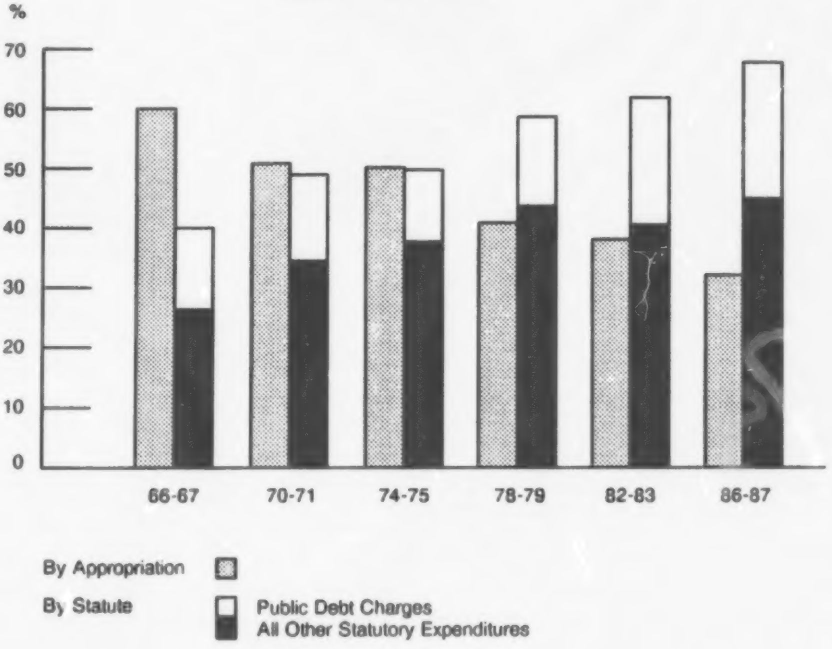
1.46 If this kind of information were available on all departmental expenditure programs, it would go some way toward enabling Members of Parliament to more clearly pinpoint the factors and forces contributing to deficit financing, the growth of the public debt and the costs of servicing that debt.

1.47 **More opportunity to consider debt and deficit.** It is not my place to suggest to Members of Parliament how they should go about their business. However, I believe that Parliament would benefit from more specific and formal occasions to consider debt and deficit issues, and to examine the spending and funding proposals of the Government in that context.

1.48 At the present time, Parliament's considerations of the Budget, the Main Estimates and Appropriation Acts, and the Borrowing Authority Act remain rather disconnected. Background papers to the Budget, most notably the Fiscal Plan, provide a summary of the Government's policy stance on deficits and debt, together with historical public finance data. Released shortly afterward, the Main Estimates provide details on expenditure proposals covering statutory expenditures as well as those requiring the authority of annual Appropriation Acts. However, the Estimates do not return to the question of how the expenditures will be financed, and discussion of statutory expenditures (Exhibit 1.1) is limited. The period set aside for debate on the Borrowing Authority Act permits Members of Parliament to question the Government's proposed borrowing program. Although the debate on this Act is wide-ranging, there's not a great deal of supporting information and analysis on either the borrowing program, its underlying causes or its potential medium-term financial implications.

Exhibit 1.1

PERCENTAGE OF EXPENDITURE VOTED BY APPROPRIATION AND BY STATUTE 1966-67 TO 1986-87



Source: Calculations performed using the current Public Accounts of Canada, Volume 1, of each period indicated. Prior period adjustments, to reflect subsequent accounting changes, not considered.

1.49 Debate on the Budget and the Borrowing Authority Act has become more co-ordinated through a change in the parliamentary schedule. I strongly support efforts that help focus Parliament's attention on the linkages between expenditures and revenues, as presented in the Budget, and the residual financing requirement where the Government borrows from other sectors of the economy and from non-residents.

1.50 **More input needed.** The detailed information to substantiate the benefits of any program – whether statutory or annually approved – will have to be provided by the individual departments and agencies. That is no easy task, as our study of the Estimates demonstrates. But it is, in my view, a key link in the accountability chain.

1.51 Summary analysis of the deficit, its root causes and the direction in which it is moving, would also be helpful input to Members' consideration of the proposed Borrowing Authority Act. Moreover, there would be an opportunity to bring other information, relevant to debt control as well as to the borrowing program, into the discussion. Of particular importance is the fact that the amount the Government must borrow depends on factors other than the budgetary imbalance, including the net impact of the foreign Exchange Fund Account transactions on the Consolidated Revenue Fund. To some extent, these have offset budgetary deficits in recent years.

1.52 **The Important Information.** The following information could be developed and transmitted to Parliament as background to the debate on the proposed Borrowing Authority Act:

- analysis of the budgetary fiscal stance, with particular focus on the sources of the deficit and the Government's strategy for debt management in general;
- analysis and articulation of the deficit and debt consequences of each major fiscal initiative;
- an analysis of the borrowing program with its key strategies for the future as well as full disclosure of past program costs;
- analysis of government programs that can, in whole or in part, be deemed to be in the nature of investments with long-term benefits – and thus more appropriate for funding through borrowing;
- projections of debt loads (debt compared to national income) and debt burdens (debt servicing costs compared to national income) and the sensitivity of these projections to a variety of assumptions about major economic indicators (Exhibit 1.2 provides a historical perspective); and
- projections of the impacts on the economy of alternative deficit and debt reduction strategies.

1.53 It would be up to the Department of Finance and the departments initiating programs to provide this information. In addition, Members of Parliament might wish to invite the Bank of Canada – the Government's fiscal agent – to contribute background information.

1.54 As I have already noted, I have something more to say at the close of the chapter about debt and its implications.

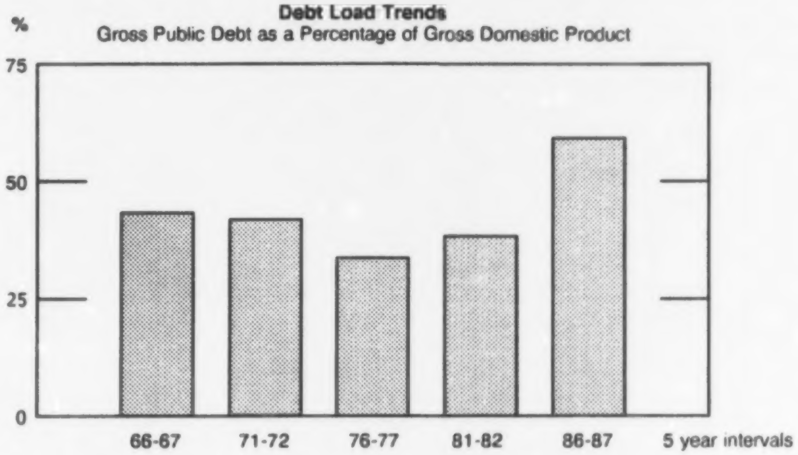
Continuing Problems

1.55 The encouraging news in our study of well-performing organizations and the progress reported in the evolution of the Part IIIs must be balanced against continuing and potential problems revealed by our departmental audits – though we also report improvements.

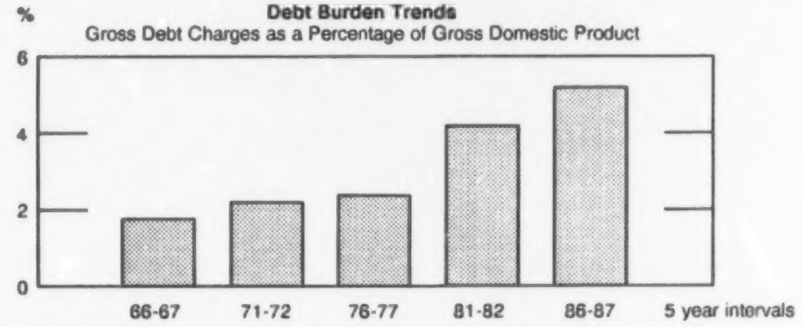
Exhibit 1.2

DEBT BURDEN TRENDS VS DEBT LOAD TRENDS
1966-67 - 1986-87

Debt Load Trends
Gross Public Debt as a Percentage of Gross Domestic Product



Debt Burden Trends
Gross Debt Charges as a Percentage of Gross Domestic Product



Source: Department of Finance "The Fiscal Plan", February 10, 1988.

1.56 Five matters emerging from this year's chapters seem to me of such significance that I discuss each of them separately further on. Here I simply touch on the kinds of problems that persist year after year.

1.57 **Little sense of urgency**. My overall verdict is that the departments and agencies of government take an inordinate length of time in coming to grips with problems, even when those problems have long since been identified.

1.58 Chapter 2 of this year's Report contains my Observations on the Financial Statements of the Government of Canada. Over the years the Government has come a long way in responding to my concerns about the lack of appropriateness of some of its accounting policies and the lack of completeness of the Statements. My audit Opinion this year contains three Reservations, reflecting my view that in these instances the Financial Statements do not present information fairly. I hope that, in the two and a half years which remain before I leave this Office, all Reservations can be removed.

1.59 **Federal Government Reporting Study.** The major recommendation of the Federal Government Reporting Study, completed two years ago by my Office and the United States General Accounting Office, was that Members of Parliament and others should have available to them an annual financial report on the activities of the federal government that would be concise and credible. Such a report could be written in non-technical language. It would make the Government's Financial Statements more understandable, and therefore more useful to MPs as they seek to fulfil their fiscal responsibility as the representatives of the taxpayers of Canada.

1.60 I continue to press for it.

1.61 **Procrastination.** Our Audit Notes chapter (Chapter 3) reveals a spectrum of problems identified in the course of our auditing. These include the failure of a department to take any action for over a year on collecting money owed to the Crown. As we state in the audit note: "Good management of public funds would require that prompt action be taken to collect money that is owed to the Government." The chapter also discloses that a decade after the Public Accounts Committee recommended that it be disposed of or its use changed, a lease of unused land on Vancouver's North Shore continues, costing the taxpayers close to $800,000 each year. While I recognize that finding the best solution to this particular problem is difficult, I cannot believe that some settlement cannot be worked out. We first reported this matter in 1976.

1.62 At the other end of our country the Government has, since 1966, in effect subsidized the operation of a toll bridge in Saint John, New Brunswick. The Audit Notes chapter tells the story of how advances by the Government of Canada for the bridge's operation have not been repaid and how further subsidies continue. Increased tolls that might have made it possible to eliminate the subsidies have never been introduced.

1.63 **Systems troubles.** Our 1987 Financial Management and Control Study reported on the introduction and development of computerized financial management information systems in government. It told of a pattern of project failures, cost overruns and poor operating performance. This year's audit of the Canadian International Development Agency (Chapter 9) reveals that precisely these kinds of problems have plagued the development and implementation of the Agency's Aid Information System.

1.64 **Progress is slow.** While our audit of the Atlantic Fisheries (Chapter 13) notes significant progress, many problems persist that the management of the Department has been aware of for many years.

1.65 Again, our Special Audit of Major Capital Projects (Chapter 19) tells of planning extended over periods of 10, 13 and 15 years. Needs can change so significantly over such a long time span that it is almost inevitable that diseconomies will result.

1.66 One of the main reasons for the 1977 integration of the Department of Manpower and Immigration and the Unemployment Insurance Commission was to improve co-ordination and harmonization of their services. Yet our audit of the Unemployment Insurance Account (Chapter 18) reveals that, after more than ten years, a lack of co-ordination and communication between the insurance and employment arms of the Canada Employment and Immigration Commission is hindering the prompt re-employment of unemployment insurance claimants; and is impeding the Commission in realizing potential savings in unemployment insurance payments.

1.67 It seems that the lesson has yet to be learned that timely attention to problem areas is essential to achieving cost effectiveness.

1.68 If the Department of Indian Affairs and Northern Development (Chapter 14) is slow to act on long-standing problems, the complex political climate in which the Department constantly operates is no doubt largely to blame. Meanwhile, however, a great deal of money is expended but, without a clear mandate from Parliament, neither the MPs nor our First Peoples themselves have much assurance that it is being spent effectively.

1.69 **The pace is leisurely.** This year's status report on the actions taken by departments and agencies (Chapter 20) follows up on the recommendations in my 1986 Report. In some cases considerable progress has been made. In others little has transpired. In the majority, while some action has been proposed or initiated, the pace of corrective action remains unhurried.

1.70 Canadians, who contribute their hard earned dollars toward the provision of the Government's services, deserve better. In my more pessimistic moments I wonder if trying to contribute to improved practices within the federal government isn't a little like attempting to fine-tune an anvil.

Five Issues of Special Significance

The Compass of Accountability

1.71 There are constant reminders throughout the chapters of this Report that funds flow out from the federal public purse to other levels of government, to industries, to non-governmental organizations, to Indian bands, and to other individual Canadians. As well, the Government enters into contracts, and, on occasion, contracts out entire activities. What assurance does an MP have that these moneys are being used in the ways that Parliament intended? And that the activities thus funded are being carried out cost effectively?

1.72 **Federal-provincial programs.** The significance of these questions is highlighted by the results of our audit (Chapter 10) of the management of federal-provincial contribution programs in the Department of Energy, Mines and Resources. In the chapter we report on the multi-million dollar development funds that were intended to direct federal money toward the infrastructure necessary for the eventual production of offshore oil and gas. We also report on the Department's Mineral Development Agreements with a number of provinces.

1.73 **Weak accountability**. In each case we found that there was weak accountability to Parliament. The $200 million Canada-Nova Scotia Development Fund illustrates that money has been spent in ways that Parliament probably did not intend.

1.74 The purpose of the Fund, which was agreed to in 1982 and signed in 1984, is to finance infrastructural costs directly or indirectly relating to the exploration for or development, production or transportation of oil or gas in the Nova Scotia offshore.

1.75 By March 1988, $186 million of the $200 million had been committed, and $130 million of this had already been spent.

1.76 We have determined that a number of the projects being financed by these federal tax dollars – projects representing more than $100 million in committed funds, of which over $75 million has already been spent – are, in our view, questionable in relation to the criteria in the Development Fund Agreement. These questionable projects include highways and bridges which, because of their geographical location, would require a leap of imagination to visualize being linked to offshore development. Other questionable projects include a ferry service and terminal connecting Halifax and Dartmouth, a computerized traffic light control system for Halifax-Dartmouth, and a contribution to a sewer system in South Dartmouth.

1.77 **Parliament's role eroded.** One overall conclusion seems certain: in the delivery of these programs Parliament's intentions and Parliament's accountability role have been eroded.

1.78 As I have already written, the federal government enters into numerous arrangements, agreements and programs, through which funds are directed to other levels, organizations and agencies which then have the responsibility for using these moneys. My concern is that Parliament should be assured that these dollars from the public purse are spent as Parliament intended and with due regard for value for money.

1.79 **Similar problems previously reported.** In the case of Health Insurance payments to the provinces, a 1987 audit by this Office found that the Department of Health and Welfare did not obtain explicit assurance that provincial health plans were being operated in compliance with legislation. Similarly, a 1984 value-for-money audit of the Department of the Secretary of State noted the absence of any requirement for provinces to account for their use of federal funds directed to post-secondary education.

1.80 **More examples this year**. Meanwhile our audit of the Canadian Forestry Service, described in this Report (Chapter 7), reveals that current program planning and delivery procedures do not always provide information to determine whether funds transferred to provinces through Forest Resource Research Development Agreements are being spent in accordance with the guidelines in those agreements.

1.81 Our audit in the Department of Indian Affairs and Northern Development (Chapter 14) reiterates a 20-year-old concern of this Office, that the funding process for Indian bands provides little assurance that the funds have been used for their intended purposes.

1.82 Our audit (Chapter 9) of the Canadian International Development Agency (CIDA) reports that while non-governmental organizations are implementing projects in accordance with the agreements by which the Agency provides funds, CIDA's own procedures for monitoring and controlling these contributions are inadequate.

1.83 Also troubling – especially in the light of recent events involving defence contracts in the United States – are the findings of our review (Chapter 16) of government contracting at the Department of Supply and Services (DSS). Often complex and for very large sums of public money, some of these contracts – most of them defence contracts – involve not only prime contractors but more than one level of subcontractors.

1.84 Our blunt conclusion is that certain aspects of government contract audit coverage at DSS are deficient and therefore do not provide adequate protection to the Crown.

1.85 Equally troubling are our audit observations (Chapter 6) in regard to the Group Surgical Medical Insurance Plan, the largest private health insurance plan of its kind in Canada. It provides supplementary medical coverage for 400,000 public sector employees and pensioners. Although the Plan has been operating for almost 30 years, the Government has not paid close attention to the activities of the insurance company which underwrites the Plan and annually pays out $85 million in claims. Vigorous monitoring would result in better premium rate setting procedures, more efficient claims processing, and significant cost savings, which we estimate could exceed $3 million annually.

1.86 The Government provides grants and contributions to a large number of enterprises. We conducted a special audit (reported in Chapter 19), one aspect of which was to explore whether departments funding projects are aware that a project may also be receiving funds from another department. We found relatively few cases of commercial recipients receiving funds under more than one federal government program for the same project; but in those instances, communication between donor departments was weak and there was a risk of double funding.

1.87 **Achieving Parliament's purposes**. All these instances emphasize the difficulty of ensuring that the taxpayer's dollar is being spent in accordance with Parliament's wishes and is being spent cost effectively when funds are transferred or given out as subsidies, or when programs are contracted out.

1.88 Monitoring becomes all-important.

1.89 I do not underestimate the major work performed by internal audit, or that of the Audit Services Bureau. And the role of the auditors general of the provinces is also very important. However, not all of them have value-for-money mandates; nor, of course, are the results of their audits reported to the Parliament of Canada.

1.90 I find disquieting the many illustrations in this Report of the difficulty in watching over the funds that flow from the federal government.

1.91 **One taxpayer**. Individual taxpayers contribute those funds to three – sometimes four – levels of government, each claiming to represent the best interests of the taxpayer. About half the contents of the average Canadian family's purse and wallet finds its way into these government treasuries. Whether this money is spent at the federal, provincial or local levels, the taxpayer deserves to know that it is spent with due regard for economy, efficiency and effectiveness. We in the public sector should be able to provide that assurance. If that requires more communication between auditors at each level and a more integrated system of reliance on one another's work, then so be it. Perhaps Canada should be moving more strongly toward what might be called a single audit concept.

1.92 The 1987 Meech Lake Constitutional Accord may well lead to even more varied and extensive federal-provincial funding arrangements. The intent of the Accord is "to foster greater harmony and co-operation between the Government of Canada and the governments of the provinces."

1.93 As Auditor General of Canada I shall be pressing the point that greater co-operation must also include greater accountability for how every dollar of public funds is spent under such agreements.

1.94 **Crown corporation accountability revisited.** Considerable sums of federal funds still flow through Crown corporations. Over a number of years, culminating in 1982, this Office directed Parliament's attention to certain weaknesses in the framework for the accountability and control of Crown corporations. In response to the concerns that I and others raised, an improved framework was introduced: Part XII of the Financial Administration Act took effect in September 1984. With the exception of certain cultural and other corporations that were exempted from its provisions, this omnibus legislation applies to all parent Crown corporations and, through them, to their wholly-owned subsidiaries.

1.95 These relatively new provisions are significant in that they govern activities which, in total, are almost equivalent to the magnitude of government activities carried out through departments and agencies. Because of this, I have initiated a study to review the implementation of Part XII. It will focus on answering the question: Is the legislation working as intended? The results will be included in my 1989 Report.

Inspections

1.96 The preceding discussion is a reminder that governments cannot do everything themselves. However, where the health, safety and well-being of Canadians are involved, government has the responsibility for establishing and enforcing appropriate regulations; and for maintaining high standards in its own conduct of inspections.

1.97 Our audit of the Department of Agriculture's Food Production and Inspection Branch (Chapter 8) and a segment of our audit of the Atlantic Fisheries (Chapter 13) are reminders of the responsibilities of government in this area.

1.98 That food products are safe is the shared concern of governments, industry, exporters and importers, and consumers. It's in everyone's best interest to ensure that the highest standards are achieved and maintained. The departments of government can build on this mutuality of interest. At the same time, they must make sure they are fulfilling their own specific roles.

1.99 Canada has an enviable reputation for the excellence and wholesomeness of the agricultural and fishery products we eat, and which we export throughout the world. However, what our audits reveal – particularly our audit of the Food Production and Inspection Branch – is that government's ability to maintain this high reputation is under stress. Improved assessment is needed to determine where risks are most serious, so that resources can be concentrated in these areas. Certain inspection practices should be strengthened. There is a need to process promptly the registrations of pesticide products, without, of course, compromising health or the environment.

1.100 These are matters of importance to all Canadians.

Collecting Taxes: Striking a Balance

1.101 I want to focus on one aspect of our audit of the tax collection function at Revenue Canada - Taxation (Chapter 17). In doing so, I wish to emphasize that the chapter covers a broader area than my concern here. However, the particular issue seems to me to be a telling illustration of how a change in viewpoint can affect the work of a department.

1.102 The volume of write-offs – that is to say the income tax owed that the Department has decided is unrecoverable – escalated from $50 million in fiscal year 1982-83 to $600 million in fiscal year 1986-87. This year the volume of write-offs is declining.

1.103 Our audit recognizes that this very large increase, from 1982 to 1987, in the amounts owed in income taxes that cannot be recovered is due to a number of factors. One of these was the economic downturn of the first half of the 1980s. And the unhappy experience with the infamous Scientific Research Tax Credits can, in part, be blamed.

1.104 **An attitudinal change.** However, another inescapable factor relates to an attitudinal change. The mandate of the Department is to ensure that taxes are collected. It is empowered to take action – sometimes strong legal action – against delinquent taxpayers. But the individual rights of those taxpayers must always be respected; and there are also political, social and humanitarian dimensions to be taken into account. Canadians were rightly offended some years back by media reports alleging that already impoverished Canadians' family homes were being sold from over their heads in order to recover unpaid taxes.

1.105 I believe it was Martin Luther who said that all human history is like an intoxicated man riding home from a tavern. In his inebriated state, he leans too far in one direction – and falls off the right hand side of his horse. Determined not to make the same mistake again, he continues his journey leaning to the left – and falls off that side. Thus tumbling off alternately to right and left he somehow makes it home. So with history; we move from one extreme to its opposite.

1.106 When our audit reveals that uncollectable taxes rose by so large an amount in just four years, I have to wonder if the Department – which was heavily criticized for being too severe in its collection methods in the early 1980s – was not, during this more recent period, in danger of falling off on the other side. Canadians believe in fairness. But fairness also requires that the quiet majority who pay their full taxes on time should not be eventually penalized by having to compensate for those who fail to pay their share.

1.107 **A larger issue.** I am aware that in addressing the particular issue of the non-collection of identified taxes I am likely only touching the surface of a much larger problem. Identified uncollected taxes are probably small in comparison with taxes that are lost through deliberate non-compliance and evasion.

1.108 In this whole area, it behooves government to be firm, fair and vigilant. Our income tax system relies on the voluntary compliance of taxpayers. And, in turn, the continuance of that voluntary compliance rests on the recognition by Canadians that the system is equitable and even-handed. If taxpayers begin to sense that others are taking advantage of the system, that perception could have an immense negative impact on the ability of future governments to collect tax revenues.

1.109 **Good news.** The encouraging news is the Department's report that the volume of uncollectable taxes has begun to be reversed. The Department must also be commended for its efforts to collect the refundable amounts still owed to the Government from the Scientific Research Tax Credit program. Its determined actions have gone some way in limiting the program's potential losses of $1.2 billion.

Canada's Forests

1.110 Perhaps because I was born in British Columbia and, before coming to Ottawa seven years ago, lived all my life there, I find the results of our audit of the Canadian Forestry Service (Chapter 7) disquieting.

1.111 **A provincial jurisdiction.** Since Confederation, forestry has been almost exclusively a provincial responsibility. Nonetheless, there is a federal presence. The Forestry Development and Research Act mandates the Canadian Forestry Service to promote and enhance the sustained economic use of Canada's forest resources through environmentally sound forest management, and to enhance the social and economic benefits derived from publicly and privately owned forests and from forest related activities in Canada. Forest Resource Development Agreements, involving cost sharing, have been signed with all provinces with the aim of achieving national forestry objectives.

1.112 The Department has reported that, although a major goal of the federal government's agreements with the provinces is to reduce the backlog of unsatisfactorily restocked forest land in Canada, restocking has not kept pace with the harvest. And the Canadian Forestry Service does not have adequate information, or a national system in place, to know the true state of the national forest resource.

1.113 **Troubling signs.** Now, all may be well. It may be that the provinces which have jurisdiction in these matters are ensuring as their first priority the continuing integrity of the forest resource, and the protection and enhancement of its productive capacity. But our audit of the federal involvement casts long shadows of doubt. Acid rain, insect infestation, and the economic consequences of poor forest management practices, do not respect provincial boundaries.

1.114 Given the importance of our forests to all Canadians, I believe that the Government – through the Canadian Forestry Service – should make strenuous efforts to ensure that state-of-the-art standards for reforestation and forest management are built into future agreements with the provinces. The Government should also ensure that timely and accurate information on Canada's total forest resource is readily available.

1.115 **Canada's heritage.** Over 40 years ago, the then Chief Forester of Canada, D. Roy Cameron, wrote that "the principal forest problem in Canada is improving protection against fire, insects and disease. Exploitation is carried on almost without regard to regeneration. Much further research in these areas is needed." Today we still face these same problems, and some new ones. Our audit raises thorny questions as to whether enough is being done to ensure the continuing viability of Canada's forests.

1.116 Their future is in the hands of the provinces. But I would guess that most Canadians regard their country's forests as a national resource, to be harvested wisely and renewed even more wisely, so that this splendid heritage may be passed on undiminished to future generations.

1.117 I believe that Members of Parliament, representing all Canadians, will share my concern.

The Cost of Information

1.118 An issue that I have written about previously is given further substance in this year's Report. It is the reality that providing information costs money. There is a growing recognition that in our information-oriented society information itself and the technology that produces it add up to a costly and valuable resource.

1.119 Our study in the Department of Finance which we have called "Managing the Income Tax Information Burden" (Chapter 12) focusses on this important matter. We looked at four tax measures introduced, modified or proposed during the last ten years. These affect individuals, corporations, the Government itself, and third-party providers of information. Our objective was to determine the extent to which the information burden is taken into consideration when tax measures are being designed and implemented.

1.120 **A growing problem.** I am well aware that this whole subject is of immediate interest to Members of Parliament, all of whom are the recipients of complaints – from corporate taxpayers, small businesses and individuals – about the cost of professional advice and the necessity of employing additional staff just to comply with what they identify as Ottawa's bureaucratic processes.

1.121 Our study reveals that certain tax measures place a considerable burden on the private sector. For example, we have estimated that the proposed new tax assisted retirement savings rules - for which draft legislation was released in March 1988 - will involve one-time costs in the order of $330 million for the corporations required to provide information about their employees. Approximately $170 million represents the cost for review and possible amendment of existing plans; approximately $100 million represents the costs of providing information and counselling to plan members; and approximately $60 million represents the cost of setting up systems to report information to the Department of National Revenue-Taxation. A further annual cost in the order of $15 million will be incurred to comply with reporting requirements.

1.122 It is apparent that the designers of tax policies are aware of such costs. However, more systematic consideration could have been given to their effect when the tax measures we examined were being designed.

1.123 Our study reveals that the Government has made some progress in achieving value for money in the management of information. It also reveals that there is much more that can be accomplished in this area.

1.124 **Future-oriented information.** Another dimension of potentially high significance emerges from our study. We examined three tax measures that were already in place. But we also looked at one measure – the proposed tax assisted retirement savings rules – that had not been enacted. Parliamentary consideration has been postponed to 1989.

1.125 In essence, therefore, we looked at an event that had yet to take place.

1.126 The worldwide auditing profession is presently involved in a debate about the validity of auditing future-oriented information. There is a growing demand in both the private and public sectors for such auditing. During my own tenure as Auditor General, I have been frequently told by MPs that, while my Office's auditing of activities that have already taken place is undoubtedly useful, what would be of even more value would be timely information about the financial consequences of proposed courses of action.

1.127 The message of our study is that government can and should provide a qualitative and quantitative depiction of the impact of the information burden. These estimated costs could be readily available both to Members of Parliament and to those who would be affected by the legislation.

1.128 Meanwhile I will be ensuring that the methodology developed in this year's study is applied in our audits of departments and agencies. Information must be increasingly regarded as a valuable commodity and resource, and the Government – which is largely in the business of information – must be held to account for its wise use and management.

Comprehensive Auditing Evolves

1.129 Comprehensive auditing's progress has been marked by a number of recent events.

1.130 **The Senate Committee on National Finance.** In the fall of 1987, the Standing Senate Committee on National Finance reviewed the concepts of comprehensive auditing in a series of hearings whose purpose was "to understand the complexities of comprehensive auditing and, if possible to draw conclusions and recommendations for both the practitioners and the users of this process." The Committee's conclusions emphasize the need to clearly define what is meant by effectiveness; they stress the importance of the Part IIIs of the Estimates for reporting on value for money. And the Committee advocates more frequent reporting by the Auditor General. The Senate Committee's report is included as Appendix D to this Report.

1.131 **The Canadian Comprehensive Auditing Foundation.** Effectiveness was also the subject of a major report issued in October 1987 by the Canadian Comprehensive Auditing Foundation. Its thrust is that the future of comprehensive auditing lies in auditors providing assurance on management representations about effectiveness. The Report acknowledges that a political environment does not always lend itself to providing complete information; a point also made by our own audit of the Estimates (Chapter 5).

1.132 I have no doubt that the verification of steadily improving management information will be an increasingly important role for legislative auditors. However, I also believe it will continue to be necessary for the Auditor General of Canada to bring independent information directly to the attention of Parliament.

1.133 **The Canadian Institute of Chartered Accountants.** One of the issues noted in the Senate Committee's Report is that the selection of criteria for value-for-money auditing is a sensitive area. Selecting criteria is also a key element in the Statement on Value-for-

Money Auditing Standards issued in March 1988 by the Public Sector Accounting and Auditing Committee of the Canadian Institute of Chartered Accountants (CICA). This important statement recommends standards for the professional qualities of value-for-money auditors, the conduct of the examinations and the content of their reports.

1.134 **The Public Accounts Committee.** The Public Accounts Committee's busy year implicitly re-emphasized the value of comprehensive auditing. The Committee examined in depth the results of our 1987 Financial Management and Control Study. The Committee also stressed the importance of the follow-up process as integral to the accountability of departments and agencies. This is the fourth year that I have reported on the status of action taken in response to our previous observations and recommendations (see Chapter 20). I am pleased that the Committee has found these initiatives to be useful.

1.135 Also of great potential significance is the Committee's recommendation that the House of Commons should create a Budget Committee. This Committee's review of expenditures before they are made would parallel the Public Accounts Committee's review after the fact (see the 12th Report of the Committee, printed in Appendix C).

1.136 **Improving communication.** One of my own personal quests has been to communicate the results of our auditing as effectively as possible. Readers will note three changes in this year's Report.

1.137 First, I have included as Chapter 2 my Observations on the Financial Statements of the Government of Canada. Our auditing of the Statements represents a major segment of my Office's annual work; the Financial Statements themselves contain important information for Members of Parliament. I believe it is appropriate, therefore, to include my Observations as a chapter of this annual Report.

1.138 Second, this year's chapters are shorter. I am aware of the many demands on the time of Members of Parliament. So I have made a determined effort to exclude unnecessary verbiage.

1.139 Third, we have eliminated the previous General Summary Chapter. Instead, each chapter begins with a page of "Main Points". These main points have also been brought together as a separate pocket-sized booklet. I hope that this new booklet will prove to be a useful ready reference to the annual Report.

1.140 **Videos.** To tell the results of our auditing even more clearly, and following a pilot effort in 1986, last year we made six audit reports available as videotape summaries. The videos were placed on the parliamentary OASIS system. One year is insufficient to test the worth of a new initiative; so we have produced videos of three of our 1988 audit chapters. In addition, as in 1987, we have produced a video on the highlights of my Opinion on the Financial Statements.

1.141 I hope that these initiatives will prove useful to the Public Accounts Committee, to other Members of Parliament and to individual Canadians.

The Numbers Have Meaning

1.142 Earlier in this Chapter I discussed some aspects of managing the public debt. I am an accountant, not an economist; also I am aware that decisions that affect the size of our nation's debt are policy decisions, to be made by those elected by Canadians to serve in Parliament and form the Government. However, there's nothing very mysterious about the basics of accounting. And Members of Parliament know that the numbers they deal with, in the Budget, the Estimates, the Appropriations, and the Accounts of Canada, all have a meaning.

1.143 One inescapable meaning is that the Government continues to need to borrow money.

1.144 **Three scenarios: one message.** I find it helpful to compare the ways in which it is possible to look at the relationship of revenues, the cost of programs, and the need to borrow. My three scenarios are based on the experience of the last 15 years and on the Government's own projections.

1.145 If some Members of Parliament believe that servicing the national debt is the priority, then they must first deduct debt servicing charges from total revenues, and calculate what is left to pay for all the programs of government. Whatever remains will not be enough. So, in the absence of substantial tax increases, more money must be borrowed, and the total debt increases.

1.146 Another group of Members of Parliament might take the view that programs are the priority. They would therefore first take the cost of the programs out of the revenues available, and use the balance to service debt. But the balance would not be enough. So, again without increased taxation, more money has to be borrowed to pay interest on debt already incurred. And the total debt inevitably increases.

1.147 A third group of Members might want to know what money is left over after paying for statutory programs, including the costs of servicing the existing debt. They would therefore deduct from available revenues the cost of these already existing commitments. They would discover that there was insufficient money to continue existing discretionary programs. Therefore, without higher taxes, spending approvals by Parliament would mean borrowing more money for ongoing programs, let alone new ones. And the overall debt increases.

1.148 Each of these three accounting models or approaches demonstrates the obvious reality that spending in excess of revenues requires financing. The further reality is that this financing involves both borrowing money and paying interest on that money through the years to come.

1.149 A government may manage economically. It may eliminate or reduce certain programs. It may be helped by a buoyant economy. It may reduce the size of the annual deficits.

1.150 But the meaning of the numbers is that as long as program costs plus debt servicing exceed annual revenues, more money must be borrowed, more future interest costs incurred, and an ever larger debt accumulated.

1.151 With high levels of deficits and interest rates, a greater proportion of the taxpayer's dollar has been going to debt servicing and a decreasing portion to actual programs. In the meantime, while the debt is growing, new programs, many involving statutory or long-term commitments, are being undertaken. The meaning of the numbers is that a future Government may find itself employing almost all its time and energy attempting to fund past commitments and service past debt, and have little or no current revenue to challenge the future.

1.152 In 1980, Canada's Hugh MacLennan published a novel in which he has one of his characters say:

> Man is a thinking animal, a talking animal, a tool-making animal, a building animal, a political animal, a fantasizing animal. But in the twilight of civilization he is chiefly a taxpaying animal.

1.153 Good management of the public purse can help hold off that twilight. I hope this Report contributes to achieving that good management.

1.154 But only political will and political courage can stem the implacable increase in Canada's burden of debt; and ensure that night does not fall.

OBSERVATIONS BY THE AUDITOR GENERAL ON THE FINANCIAL STATEMENTS OF THE GOVERNMENT OF CANADA

OBSERVATIONS BY THE AUDITOR GENERAL ON THE FINANCIAL STATEMENTS OF THE GOVERNMENT OF CANADA

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2.1 Status report: Conformance by the Government with PSAAC Accounting Statement Number 3, August 1988

2

OBSERVATIONS BY THE AUDITOR GENERAL ON THE FINANCIAL STATEMENTS OF THE GOVERNMENT OF CANADA

Main Points

The Government of Canada is a world leader in providing summary financial information about its operations in audited form. However, the information is based on certain accounting policies that I believe are inappropriate and is presented in a manner that makes it difficult to understand. (paragraphs 2.1 to 2.4)

The accounting policies that I believe are inappropriate result in:

- failure to provide an allowance for at least $1.3 billion in borrowing by Crown corporations; (2.51 to 2.64)
- failure to consolidate the financial statements of Crown corporations, causing reported assets, liabilities, revenues and expenditures to be understated by significant but as yet undetermined amounts; (2.65 to 2.70)
- failure to record about $4.2 billion in liabilities related to the indexing of employee pensions. (2.71 to 2.73)

Members of Parliament and other users need financial information about the Government that is both credible and understandable. (2.5 to 2.8)

Credibility will be enhanced if the Government modifies its accounting policies to conform with recommendations of the Canadian Institute of Chartered Accountants' Public Sector Accounting and Auditing Committee. (2.9 to 2.19)

Understandability will be enhanced if the Government presents its financial statements in a comprehensive yet succinct annual financial report similar to annual reports published by corporations in the private sector. (2.20 to 2.31)

OBSERVATIONS BY THE AUDITOR GENERAL ON THE FINANCIAL STATEMENTS OF THE GOVERNMENT OF CANADA

Introduction

Members of Parliament and other users need financial information about the Government of Canada that is both credible and understandable.

2.1 The Government of Canada is a world leader in providing summary financial information about its operations in audited form. However, the information is based on certain accounting policies that I believe are inappropriate and is presented in a manner that makes it difficult to understand. The information I refer to is contained in the Audited Financial Statements of the Government of Canada.

2.2 The financial statements of the Government for the year ended 31 March 1988, and my audit Opinion on them, are in Section 2 of Volume I of the Public Accounts of Canada. In this chapter, I present additional information and comments on the Government's financial statements and my audit Opinion. In prior years, this additional material was presented in Section 3 of Volume I of the Public Accounts.

2.3 The Government's financial statements convey a highly summarized overview of its various activities. The overview includes the Government's cash balances and investments together with amounts owing to and by the Government at the end of the year (its financial position), what its revenues and expenditures for the year have been (the results of operations), and the extent to which cash going out exceeded cash coming in (the Government's financial requirements).

2.4 My audit Opinion tells readers about two matters. First, whether the financial statements were prepared according to the Government's accounting policies, applied consistently from year to year. Second, whether users of the statements can rely on them to present fairly the Government's financial position, results of operations and financial requirements.

2.5 I believe that Members of Parliament and other users need financial information about the Government that is both credible and understandable.

2.6 The Canadian Institute of Chartered Accountants' Public Sector Accounting and Auditing Committee (PSAAC) is developing generally accepted accounting principles (GAAP) appropriate for Canadian governments. Public Sector GAAP should help make the Government's financial statements more credible by providing objective standards of good accounting and reporting practice that the Government can use in preparing its financial statements and against which I can audit.

2.7 In my judgment, the Government's financial statements would be more understandable if they were presented in a comprehensive but succinct annual financial report, similar to the annual reports published by corporations in the private sector. A concise annual financial report would show users "the big picture" in plain language and would serve as a key to the considerable detail that the Government provides elsewhere.

2.8 Preparing financial data in accordance with PSAAC recommendations, and presenting it in a concise annual financial report, are important initiatives for the Government to pursue. Continued support and encouragement from Members of Parliament will help create the climate within which this work can be accomplished.

The Canadian Institute of Chartered Accountants' Public Sector Accounting and Auditing Committee (PSAAC)

The Government's financial statements would be more credible if the accounting policies used in preparing them were modified to conform with recommendations of the Canadian Institute of Chartered Accountants' Public Sector Accounting and Auditing Committee.

2.9 At the present time, the federal and provincial governments in Canada prepare their financial statements in accordance with accounting policies that each has developed. These accounting policies differ from government to government. As a consequence, it is difficult for those who use the financial statements to compare one government with another.

2.10 It is also difficult for those who prepare and audit government financial statements to determine when they present information fairly and when they do not. Although progress is being made, there does not yet exist an agreed-upon set of standards for good accounting and reporting practice to help users get the information they need and to help preparers and auditors assess fairness.

2.11 In March 1981, the Board of Governors of the Canadian Institute of Chartered Accountants established PSAAC. The 19-person committee is composed of senior public sector officials, public accountants and academics. Public sector officials include Deputy Ministers, Comptrollers and Auditors General and senior executives of government-owned corporations from both the federal and provincial governments. Input and advice is sought from about one hundred other people, including users, preparers and auditors of government financial statements. PSAAC provides a forum for considering the needs of users, preparers and auditors, and an opportunity to develop and recommend enhanced accounting principles and disclosure standards for consideration by Canadian governments and their legislative auditors.

2.12 The existence of PSAAC does not alter the responsibility of legislative auditors to exercise independent, professional judgment when they examine and report on government financial statements. However, PSAAC can help legislative auditors discharge this responsibility better by developing a consensus view of appropriate financial reporting practice that both governments and auditors can refer to in assessing fairness. The result should be financial statements and audit reports that are more attuned to user needs and more comparable, both over time and from government to government. In my judgment, this would greatly enhance the credibility of government financial statements.

2.13 At the time of preparing this chapter, PSAAC had issued three statements on accounting and four on auditing. On the accounting side, the Committee began by issuing Statement 1 on disclosure of accounting policies. The Committee then decided to undertake three projects aimed at establishing a framework for generally accepted accounting principles and financial reporting standards appropriate for governments.

2.14 The first project, completed in 1984, identifies five objectives of government financial statements (Accounting Statement 2). The second was completed in 1986 and recommends general reporting principles and standards for the disclosure of information in government financial statements (Accounting Statement 3). Exhibit 2.1 provides a status report on the extent to which the Government has conformed with the 35 recommendations contained in Accounting Statement 3. The exhibit shows that current government practice is consistent with 27 of the recommendations.

2.15 The third project is well under way. It addresses the principles and criteria for determining which activities should be included in government financial statements, and how these activities should be accounted for if they are brought in.

2.16 In addition, PSAAC is working on a project that is nearing completion and which deals with accounting for government employee pensions. As well, a research study is being conducted on the recording and reporting of government physical assets. The study is designed to stimulate discussion and debate on this contentious public sector issue. Clearly, the development of generally accepted accounting principles for Canadian governments is well under way.

2.17 **Transfer payments - another matter requiring further study**. PSAAC is also planning to study how governments should account for and report transfer payment programs. In my Observations last year, I reported that I was uncertain whether the Government was accounting for one such program in an appropriate manner and called for further study. I am pleased that PSAAC has decided to address the transfer payment issue.

2.18 The federal transfer payment program that concerns me provides for payments to prairie grain farmers under the Western Grain Stabilization Act (WGSA). This is one of the Government's "automatic stabilizers"; it generates statutory payments when specified conditions occur. The fundamental issue is whether expenditures of this type should be recognized in the fiscal year when crops are harvested and payments can be estimated (the accrual basis), or in the fiscal year when payments are actually made (the cash basis).

2.19 Payments to farmers under the WGSA involve significant sums – over $1 billion annually in recent years. They have been accounted for on a cash basis, even though it

STATUS REPORT: CONFORMANCE BY THE GOVERNMENT WITH PSAAC ACCOUNTING STATEMENT NUMBER 3

AUGUST 1988

PSAAC Recommendation and Paragraph Number	Conformance By Government	
	Yes	NO
.05 The financial statements of a government should be clearly identified and should include or be accompanied by an acknowledgement of the government's responsibility for their preparation.	X	
.07 Notes and schedules that are integral to the financial statements should be clearly identified.	X	
.10 Financial statements should present any information required for the fair presentation of a government's financial condition and results of operations.		X Note 1
.13 Financial statements should be presented in such form and use such terminology and classification of items that significant information is readily understandable.	X	
.15 Financial statements should present a comparison of current period amounts with those of the prior period(s).	X	
.17 The bases for determining the reported amounts of assets and liabilities should be applied consistently and, where the bases are not self-evident, they should be disclosed.	X	
.19 Financial statements should be issued on a timely basis.		X Note 2
.21 Where the financial statements are subject to an independent audit, the auditor's report should be appended to the statements. Unaudited financial statements should be clearly identified as such.	X	
.23 Financial statements should present the substance of transactions and events.		X Note 1
.28 Notes and supporting schedules in financial statements should not be used as a substitute for proper accounting treatment.	X Note 1	
.32 Financial statements should include a statement of financial position, a statement of revenues and expenditures and a statement of changes in financial position.	X	Note 3
.35 The statement of financial position should account for the difference between a government's liabilities and financial assets at the end of the accounting period.	X	
.39 The statement of financial position should report a government's liabilities at the end of the accounting period segregated by main classifications, such as:		
- accounts payable and accrued liabilities;	X	
- employee pension obligations;	X	
- borrowings; and	X	
- loans and advances from other governments.	X	
.40 Financial statements should disclose adequate information about the nature and terms of a government's liabilities.	X	
.48 The statement of financial position should report a government's financial assets at the end of the accounting period segregated by main classifications, such as:		
- cash and temporary investments;	X	
- revenues receivable;	Note 4	
- inventories for resale;	Note 4	
- loans and advances to other governments;	X	
- other loans and advances; and	X	
- investments.	X	
.49 Financial statements should disclose adequate information about the nature and terms of a government's financial assets together with any valuation allowances.	X	
.53 Valuation allowances should be used to reflect financial assets at their net recoverable or other appropriate value.	X	
.56 Financial statements should disclose information to describe a government's material financial commitments at the end of the accounting period.	X	

Exhibit 2.1

	Yes	NO
.60 Financial statements should disclose information to describe a government's material contingencies at the end of the accounting period.	X	
.65 Financial statements should disclose information to describe a government's acquired physical assets on hand and available for use by the government at the end of the accounting period.		X
.70 The statement of revenues and expenditures should account for the difference between a government's revenues and expenditures of the accounting period adjusted for changes in valuation allowances in the accounting period.	X	
.72 Expenditures should be accounted for in the period the goods and services are acquired and a liability is incurred, or transfer payments are due.	X	
.74 The statement of revenues and expenditures should report a government's expenditures of the accounting period by function or major program.	X	
.76 Financial statements should disclose a government's expenditures of the accounting period by object of expenditure.	X	
.79 Financial statements should disclose the gross amounts of expenditures.	X	
.81 Revenues should be accounted for in the period in which the transactions or events occurred that gave rise to the revenues. Items not practicably measurable until cash is received would be accounted for at that time.		X
.84 The statement of revenues and expenditures should report a government's revenues of the accounting period segregated by significant types of revenues from taxes, non-tax sources and transfers from other governments.	X	
.86 Financial statements should disclose the gross amounts of revenues.	X	
.89 The statement of revenues and expenditures should report changes in valuation allowances in the accounting period.	X	
.92 The statement of changes in financial position should report how a government financed its activities in the period and how it met its cash requirements, including: - the changes in a governments's cash and cash equivalents during the accounting period; and - a government's total cash requirements during the accounting period.	X X	Note 3
.93 The statement of changes in financial position should classify cash flows by operating, investing and financing activities.		X
.94 The statement of changes in financial position should report significant non-cash items.		X
.98 Financial statements should present a comparison of the actual results with those originally forecast by the fiscal plan.		X
.100 Planned results should be presented on a basis consistent with that used for actual results.	X	
.103 Financial statements should present information to show where a government has exceeded its borrowing, investing or expenditure authority limits.	X	

Notes:

1. Consolidation of Crown corporations, indexing of employee pensions, and provision for Canadian Wheat Board borrowings are disclosed in notes but not booked in the financial statements.
2. Tabling in September or October is 6 or 7 months after the fiscal year-end.
3. The Government's Statement of Transactions is not in the form of a "statement of changes in financial position" as envisaged by PSAAC, although it does report changes in cash and cash equivalents and cash requirements.
4. Revenue receivables and inventories are not booked in the financial statements under the Government's stated accounting policies.

seems possible to determine much earlier the amounts that will ultimately be payable under the program. Payments for crops harvested in calendar 1987 were made after 31 March 1988, and thus are not included in the Government's Statement of Revenue and Expenditure. The question is, should they be included in expenditure of the year ended 31 March 1988 even if paid later? I have not added a Reservation to my Opinion for failure to account for WGSA payments on the accrual basis, because the practicability of doing so for the Government's other transfer programs, and the effect on them, have not yet been fully assessed.

The Need for a Concise Annual Financial Report

The Government's financial statements would be more understandable if they were presented in a comprehensive yet succinct annual financial report, similar to annual reports published by corporations in the private sector.

2.20 In 1986, the results of a two-year Federal Government Reporting Study (FGRS) were published. FGRS was a research project undertaken jointly by my Office and the United States General Accounting Office. The purpose of the Study was to identify the financial information about federal governments that users need. The primary focus was on summary data such as those provided in financial statements. The results of the Study have been provided to Members of Parliament, the Government and PSAAC for their consideration. Copies of the Study reports are available from my Office.

2.21 Throughout FGRS, we found that users of government financial reports had concerns about the information they have been getting. We also found that users were able to describe their needs for information with a fairly direct linkage to their activities. The user groups we identified were:

- legislators;
- citizens, the media, policy analysts, special interest groups and other levels of government;
- government planners and managers;
- economists;
- corporate users; and
- lenders, security dealers and their advisers.

2.22 In Canada, expert representatives of each user group began by explaining what they do and the financial information about the federal government they need to do it. The accounting and financial reporting issues that emerged were then distilled down to 16 main questions. These questions were posed to the user group experts and a sample of other knowledgeable people from each user group. Their responses were analyzed, overall findings developed and results published.

2.23 The first question dealt with how the Government's annual financial statements should be communicated. At the present time, the financial statements are presented in the Public Accounts of Canada, a three volume set of documents of massive proportions. User respondents found this presentation cumbersome and difficult to work with. They called for a simpler, more focussed approach to presenting the Government's overall numbers. And they wanted some context for the numbers in plain, non-technical language.

2.24 The prevailing view of users was that a comprehensive but concise annual financial report by the federal government would be extremely valuable. They wanted such a report to provide a broad picture and a more complete understanding of the Government's activities and resulting financial position and to serve as a key to the more detailed information the Government provides in other financial documents.

2.25 More specifically, users thought an annual financial report would bring together, in readily understood format, a consistent set of basic data about the federal government. The data would provide:

- an overview of the financial position and operating results of the entire Government;
- a common framework to enhance users' understanding of government operations;
- a common data base for analysis and for developing and debating policy positions; and
- an historical perspective from which to consider future budget and spending proposals.

In addition, an annual financial report would:

- assist users in demanding an accounting for actual results by comparison with earlier projections or budgets;
- provide a key to matters of interest about which users might want further, more detailed information;
- facilitate the communication of information on government (for example, by legislators to their constituents or by news media to their audiences); and
- save users the time otherwise needed to search through voluminous reports for information about the Government and to work out the relationships among data from various sources.

2.26 Besides basic financial information, such as the Government's assets, liabilities, revenues, expenses, deficit and borrowing requirements, most users wanted an annual report to contain other information to increase their understanding of these indicators. Supplementary information often requested included data on tax expenditures, common measures of the performance of the economy, the effects of inflation, regional breakdowns of revenues and expenses and government employment. Users recognized that such information can be presented in an annual financial report only in a highly summarized format. Nevertheless, they wanted the information included to highlight matters that they may wish to examine in more detail; the report should include references to where more detailed information can be found.

2.27 Many users also thought graphs and charts would allow information to be captured quickly and communicated easily. They wanted the charts to provide data for ten years, where possible; numerical values should also be included to facilitate analysis of trends.

2.28 The need for and uses of a comprehensive yet succinct annual financial report for the Government of Canada were very clear from the research conducted. If the Government's financial statements were presented in this type of document, I believe they would be much more understandable to users.

2.29 Since the publication of FGRS, I have been pleased to observe that the Government has taken a number of steps to improve the way in which it communicates summary information to users. In 1987, Section 1 of Volume I of the Public Accounts of Canada was completely re-done. The Section now includes a Financial Overview containing tables, charts and explanatory narrative, together with more detailed Supplementary Information. Where possible, data are presented on a comparative basis for nine years. Topics covered include the deficit and net debt, factors affecting the deficit, and factors affecting financial requirements. Public Accounts Volume I has also been reduced in size. Information not directly related to the Government's summary financial statements has been moved to Volume II. With additional work, it may well be that Volume I of the Public Accounts could become the sort of concise annual financial report that users need.

2.30 In addition, the Department of Finance now publishes two new four-page documents entitled "The Fiscal Monitor" and "The Economy in Brief". These publications are attractively presented, and contain tables, charts and text designed to help users obtain "the big picture" without getting buried in massive amounts of detail.

2.31 I encourage the Government to continue improving the presentation of summary information to users.

A Challenge for the Government

2.32 In its Eighth Report of 30 June 1987, the Public Accounts Committee endorsed "... the need for a succinct annual financial report for parliamentarians and other users of government financial information" and endorsed"... the work of the Public Sector Accounting and Auditing Committee of the Canadian Institute of Chartered Accountants."

2.33 The need for overall financial information about the Government has never been clearer. In my view, if the Government's financial statements are prepared according to PSAAC recommendations, they will be more *credible* to users. If the statements are presented in a brief but comprehensive annual financial report, they will be more *understandable* to users.

The challenge for the Government is to report more of its summary financial information in the form users need.

Background Information on My Audit Opinion

In reading my Opinion on the Government's financial statements, it is important to realize that I am not guaranteeing the absolute accuracy of the statements. Every year, the Government enters into millions of transactions involving many billions of dollars. Errors do creep in, and some might go uncorrected. When I audit the Government's statements, I seek reasonable assurance that they do not contain errors whose total effect would be material enough to mislead the reader.

2.34 In the next four sections I examine in more detail what my audit Opinion on the Government's financial statements means and how I have arrived at it.

Mandate for my Audit of the Government's Financial Statements

2.35 The mandate for my audit of the Government's financial statements is contained in section 6 of the Auditor General Act. Section 6 states that "the Auditor General shall examine the several financial statements required by section 55 of the Financial Administration Act to be included in the Public Accounts, and any other statement that the President of the Treasury Board or the Minister of Finance may present for audit and shall express his opinion as to whether they present fairly information in accordance with stated accounting policies of the federal government and on a basis consistent with that of the preceding year together with any reservations he may have".

An Overview of my Audit Opinion

2.36 My audit Opinion on the Government's financial statements consists this year of two paragraphs followed by three Reservations. The first paragraph, commonly referred to as the "scope" paragraph, identifies the financial statements that I have examined and reported on and the nature and extent of the audit work that I have performed. The second paragraph, commonly called the "opinion" paragraph, contains my conclusions about the Government's financial statements.

2.37 **The scope paragraph.** The scope paragraph begins by listing the financial statements covered by my Opinion. These financial statements, and the information they convey, are summarized as follows:

Financial Statement	Information Conveyed
Statement of Transactions	the extent to which cash going out exceeded cash coming in (financial requirements)
Statement of Revenue and Expenditure and Accumulated Deficit	what the Government's revenues and expenditures for the year have been (results of operations)
Statement of Assets and Liabilities	the Government's cash balances and investments together with amounts owing to and by the Government at the end of the year (financial position)
Statement of Use of Appropriations	what Parliament authorized the Government to spend compared with what the Government actually spent during the year (summary of appropriations available and used)

It is important to note that my audit Opinion relates only to these summary financial statements and related notes contained in Section 2 of Volume I of the Public Accounts of Canada. It does not extend to the more detailed information presented in other Sections of the Public Accounts Volume I, or to Volumes II and III.

2.38 The scope paragraph concludes by stating that my audit work on the Government's financial statements has been conducted according to generally accepted auditing standards prescribed by the Canadian Institute of Chartered Accountants. I use these standards to ensure that my audit is conducted with appropriate rigour and professionalism.

2.39 **The opinion paragraph.** The opinion paragraph contains my conclusions about two matters. First, whether the financial statements were prepared in accordance with the Government's stated accounting policies consistently applied. Second, whether the financial statements may be relied on to present fairly the Government's financial position, results of operations and financial requirements. If I conclude that the statements inform readers reliably, I state that information is "presented fairly"; if they do not, I use the phrase "do not present fairly", and add supporting "Reservations" to explain why.

2.40 This year, as in 1987, I have concluded and reported that the financial statements have been prepared in accordance with the Government's stated accounting policies consistently applied. I have also concluded that compliance with these policies results in a summary of appropriations available and used that informs readers reliably. I have therefore reported that the Statement of Use of Appropriations presents information fairly.

2.41 But I have concluded that these stated accounting policies result in a display of information about the Government's overall financial position, results of operations and financial requirements that does not inform reliably. As a result, I have reported that the remaining financial statements do not present information fairly, for the reasons set out in three Reservations.

Materiality and Audit Assurance

2.42 In planning my audit of the Government's financial statements, there are two main factors that determine the nature and extent of the work required. The first factor is a dollar figure called "materiality". This represents a threshold: if total errors fall below this threshold, the financial statements present information fairly; if they exceed this threshold and are not corrected, I refer to them in Reservations to my Opinion. The second factor is a percentage figure called "audit assurance". This represents how certain I want to be that my audit will reveal total errors that equal or exceed the materiality threshold.

2.43 At the conclusion of the audit, I determine whether the effect of uncorrected errors in the financial statements would mislead those who use the statements. If the effect would mislead, I include a Reservation in my audit Opinion.

2.44 In conducting my audit, I cannot be 100 percent certain that it will reveal all errors in the financial statements that, individually or in total, may be material. The size and complexity of the Government, as well as cost considerations, make it impractical for me to examine all or even most of the one and one-half trillion dollars worth of individual transactions entered into during the year.

2.45 What I can do is verify samples of transactions and account balances, determine whether significant financial controls within the Government are working and can be relied on to produce complete and accurate data, and carry out other procedures, such as confirming year-end balances with third parties and conducting analytical procedures to identify anomalies in the reported data.

2.46 What it comes down to is exercising professional judgment about how much auditing is required to provide reasonable assurance to readers that they can rely on reported results and not be misled.

Auditing for Compliance with Parliamentary Authorities

2.47 As part of my audit of the Government's financial statements, I examine and verify compliance with parliamentary authorities to spend, borrow and raise revenues. This is done to the same level of materiality and audit assurance established for my audit of the Government's overall financial position, results of operations and financial requirements. However, this level of materiality is significantly larger than many of the authorities being audited.

2.48 For example, spending authority is granted by Parliament in Appropriation Acts, commonly called votes. There were approximately 460 in the current year. Many departments are responsible for several votes, whose size and complexity vary greatly. Votes range in size from $7 thousand to $11 billion. It would not be practical for me to audit each vote every year to a level of materiality relative to its size.

2.49 I have therefore decided to perform detailed verifications of individual authorities on a cyclical rather than on an annual basis. The results of this work are included throughout the various other chapters in this annual Report to Parliament.

Background Information on the Reservations in my 1988 Audit Opinion

2.50 The next three sections present background information on the three Reservations contained in my audit Opinion on the Government's 1988 financial statements.

Reservation 1: Failure to provide for borrowing by Crown corporations

> **This reservation concerns the Canadian Wheat Board, an agent Crown corporation that is not included in the Government's financial statements. The Government has guaranteed the Board's borrowings, so it is responsible if the Board cannot pay. In my judgment, the value of the Board's assets is not sufficient to repay its borrowings. I believe that at least $1.3 billion of the Board's borrowings should be provided for in the Government's statements.**

2.51 The Canadian Wheat Board (CWB) buys grain from Canadian farmers and sells it on the world market. Under the CWB Act, any profit on operations is distributed to farmers, with any loss being absorbed by the Government. The terms of sales generally specify cash on delivery. However, credit sales are also made, but only with the concurrence of the Government and within guidelines it has established. The Board finances its accounts receivable from credit sales by borrowing from Canadian financial institutions. CWB's borrowings are fully guaranteed by the Government. Because CWB has no other significant assets, repayment of its borrowings depends entirely on receipt of payment for its credit sales.

2.52 As described in Note 12 to the Government's financial statements, the CWB has borrowed $3.8 billion, mainly to finance these accounts receivable. On 31 March 1988, CWB was owed approximately $3.2 billion in accounts receivable from countries experiencing difficulties in repaying their debts. Included in this figure is about $1.3 billion of interest that CWB has charged these countries. About one-half of this accrued interest has been converted to new loans by CWB on direction of the Government. This was done as part of debt rescheduling to ease the financial burden on countries experiencing repayment difficulties. These difficulties continue and, in some cases, further debt rescheduling is expected.

2.53 In my judgment, sound accounting practice requires that accounts receivable be reduced in value in circumstances where receipt is uncertain. I believe that the reported value of CWB's assets has been impaired, putting the Government at risk for some portion of the Board's borrowings.

2.54 An allowance has not been established in CWB's financial statements to reduce the value of amounts owed by countries experiencing repayment difficulties, and interest revenue on these amounts is still being recorded in the accounts. This is being done even where payments are not being received. The reason given in the Board's financial statements for not establishing a valuation allowance for these receivables is that CWB is not at risk should any of its receivables prove uncollectible, because the borrowings used to finance them are guaranteed by the Government. But what about the risk to the Government as guarantor? Surely this depends on the value of the CWB assets available to repay the borrowings that the Government has guaranteed.

2.55 According to the accounting policy stated in Note 1(vii) to the Government's financial statements, amounts receivable from sovereign states are not reduced in value unless a state has formally repudiated its debts. But why would a country formally repudiate its debts when a rescheduling agreement can be obtained that spreads out repayments over an extended period and includes a grace period of several years? Moreover, rescheduling of debts that are past due does not necessarily create assets with value, as the Estey Report on the collapse of the Canadian Commercial Bank and the Northland Bank has pointed out.

2.56 The Government has used the accounting policy stated in Note 1(vii) to determine whether assets of agent Crown corporations have sufficient value to repay corporate borrowings. If borrowings exceed a corporation's ability to repay, a liability is recorded by the Government under the accounting policy in Note 1(i). The purpose of this policy is to recognize borrowings that the Government will likely have to repay. However, application of this accounting policy does not permit the risk associated with CWB borrowings to be recognized, because the countries that owe money to the Board have not formally repudiated their debts.

2.57 I believe that the Government should provide an allowance for some portion of CWB's borrowings. The allowance would recognize the risk to the Government of countries with repayment difficulties not repaying CWB. There are many methods that may be considered in determining an allowance for amounts owed by sovereign nations. Most have been developed to value sovereign debts owed to commercial banks.

2.58 For example, regulatory agencies of several national governments have developed valuation guidelines for use by commercial banks. In Canada, the Superintendent of Financial Institutions' rules provide for the risk of non-payment by requiring that a valuation allowance be established of between 35 percent and 45 percent of loans receivable from countries experiencing repayment difficulties. Accrual of interest would also cease where countries were significantly in arrears.

2.59 Another method of valuing loans by commercial banks to sovereign nations would be by reference to prices in what is called the secondary market for foreign country debts owed to commercial banks. Banks buy and sell in this market to rearrange their holdings of sovereign loans receivable. The secondary market is relatively small compared with other financial markets and does not deal in sovereign to sovereign debts. It does, however, assign a value to the risk associated with amounts owed to commercial banks by countries experiencing repayment difficulties.

2.60 A third method of assigning a value to the risk associated with amounts owed by sovereign nations would be to provide an allowance for accrued and unpaid interest at the end of the year, whether rescheduled or not. Sound accounting practice requires that interest revenue should not be accrued when the ultimate collectability of amounts receivable is not reasonably assured.

2.61 As explained in Note 12 to the financial statements, the Government believes that payment delays on amounts receivable from sovereign nations are not *necessarily* indicative of a future loss requiring a valuation allowance (emphasis added). This may be so, but the individual circumstances of each country must be looked at separately. There may be situations where payment delays do indicate future losses. The Government does not necessarily receive preferential treatment.

2.62 I believe that an appropriate allowance for Canadian Wheat Board borrowings should be recorded in the Government's financial statements. Our analysis indicates that the allowance could range from $1.3 billion to $1.7 billion. In my judgment, the Government should record an allowance of at least $1.3 billion, the amount of accrued and unpaid interest. If this were done, reported liabilities and the accumulated deficit would be increased by at least $1.3 billion ($1.1 billion in 1987).

2.63 In saying this, I am not in any way suggesting that CWB should write off its accounts receivable from debtor countries. Sound collection practices must prevail if public assets are to be protected. But the Government is clearly at risk for at least $1.3 billion in borrowings by the CWB that it has guaranteed, and the Government's summary financial statements should reflect this reality.

2.64 I encourage the Government to revise its position on this matter and to establish an appropriate allowance for borrowings by the Canadian Wheat Board at the earliest possible date.

Reservation 2: Failure to consolidate the financial statements of Crown corporations

> **In my judgment, the Government's financial statements are incomplete. They include government activities of departments, but they do not include government activities of Crown corporations. The Government is bigger and its activities more diverse than the statements now reveal.**

2.65 The assets, liabilities, revenues and expenditures reported in the separate financial statements of Crown corporations are excluded from the financial statements of the Government of Canada as described in Note 1(i). As a result, I believe that the Government's financial statements do not provide a comprehensive and complete summary of the full nature and extent of the financial affairs and resources for which the Government is responsible. As of 31 March 1988, the net investment in Crown corporations whose financial statements are not consolidated with those of the Government amounted to approximately $20.4 billion or about 50 percent of the Government's total financial assets.

2.66 The exclusion of Crown corporation activities from the Government's statements can have a significant effect on its reported financial position and results of operations. As an example, consider the Canada Deposit Insurance Corporation, whose financial affairs are summarized in Note 17. At 31 March 1988, the unaudited financial statements of the Canada Deposit Insurance Corporation showed an accumulated deficit of $1,136 million. If the financial statements of the Corporation had been consolidated with those of the Government, the accumulated deficit would have increased by $1,136 million ($1,269 million in 1987), and the deficit for the year would have decreased by $133 million ($10 million increase in 1987).

2.67 The Government is studying how and to what extent the separate financial statements of Crown corporations should be consolidated with those of the Government, as well as alternative presentations appropriate for any not consolidated. PSAAC is also studying this issue. As an interim measure, the Government has summarized Crown corporation activities in Note 7.

2.68 Note 7 shows the Government entity (as currently defined) in one column using the modified cash basis of accounting. All Crown corporations are combined in a second column, using the quite different accrual basis of accounting that the corporations use for external reporting. Although this approach is informative, it does not provide a comprehensive and complete financial picture of the Government. This would require adding the columns together and eliminating significant internal transactions and account balances. That has not been done because the bases of accounting differ.

2.69 I hope that PSAAC will recommend a reporting entity that, if implemented by the Government, would broaden the financial statements enough to allow me to delete this Reservation from my Opinion. I am unable to determine the effect on the Government's financial statements of the failure to consolidate Crown corporations until the Government's study and PSAAC recommendations are available for review.

2.70 **A related concern - expenditures offset against revenues.** In prior years, I have called attention to the Government's practice of reporting payments as a reduction in revenues rather than as program expenditures. This practice continues. For example, in Note 3 the Government has disclosed what the effect on reported revenues and expenditures would be if payments under the Child Tax Credit program were charged to expenditure of the Social Affairs envelope, as I believe they should be. I have not included this matter in my Reservations because it has no effect on the reported deficit for the year.

Reservation 3: Unrecorded liabilities

> **This reservation concerns unrecorded employee pension liabilities. Basic pension benefits are fully provided for in the Government's financial statements, but entitlements to indexed benefits are not. In my view, an additional liability for employee pensions of about $4.2 billion should be included in the Government's statements.**

2.71 The Government has defined liabilities as financial obligations to outside organizations and individuals resulting from events and transactions recorded as of the closing date (31 March). However, in accordance with the accounting policy stated in Note 1(v), and as described in Note 11, financial obligations related to the indexing provisions of employee pension plans (including those of the Public Service, the Canadian Forces, the Royal Canadian Mounted Police, Members of Parliament and Judges) have not been fully recorded. I believe they should be. If full actuarial liabilities for all these obligations had been provided for in the accounts, reported liabilities and accumulated deficit would be increased by approximately $4.2 billion ($3.5 billion in 1987). The increase in the annual deficit will depend on how the Government decides to account for the transaction. This has not yet been determined.

2.72 Although Note 11 is informative, until the Government adjusts the financial statements to reflect an additional liability for pension indexing, the burden is on the reader to do so. I consider this both undesirable and unfair. A reader unfamiliar with financial statements may get quite a different picture than a reader with more experience.

2.73 Government officials have advised me that they will record an appropriate liability for indexing when revised employee pension legislation becomes law. At the date of signing my Opinion on the Government's financial statements, this revised legislation was still before the House of Commons. PSAAC is also studying how these pensions should be accounted for and disclosed by senior levels of government in Canada. When an appropriate liability is recorded by the Government, I should be able to withdraw this Reservation from my Opinion.

AUDIT NOTES

AUDIT NOTES

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3

AUDIT NOTES

Introduction

3.1 This chapter contains matters of significance that we believe should be drawn to the attention of the House of Commons. They have not been reported elsewhere in the Report, but have come to our attention during our audits of the Accounts of Canada, Crown corporations and other entities.

3.2 Section 7(2) of the Auditor General Act requires the Auditor General to call Parliament's attention to any significant cases where he has observed that:

(a) accounts have not been faithfully and properly maintained or public money has not been fully accounted for or paid, where so required by law, into the Consolidated Revenue Fund;

(b) essential records have not been maintained or the rules and procedures applied have been insufficient to safeguard and control public property, to secure an effective check on the assessment, collection and proper allocation of the revenue and to ensure that expenditures have been made only as authorized;

(c) money has been expended other than for purposes for which it was appropriated by Parliament;

(d) money has been expended without due regard to economy or efficiency; or

(e) satisfactory procedures have not been established to measure and report the effectiveness of programs, where such procedures could appropriately and reasonably be implemented.

3.3 Each of the matters of significance reported in this chapter was examined in accordance with generally accepted auditing standards, and accordingly our examinations included such tests and other procedures as we considered necessary in the circumstances. The matters reported should not be used as a basis for drawing conclusions about matters not examined. The instances that we have observed are described in this chapter under the appropriate department or Crown corporation heading.

Observations on Crown Corporations

3.4 The Auditor General is appointed auditor of 39 Crown corporations, under the Financial Administration Act or individual Acts incorporating specific corporations. Details of significant reservations and other matters contained in reports issued to these corporations during the year are set out below. Most of these matters have already been raised in a public forum, but they are reported here for emphasis and for consideration by Parliament.

Atomic Energy of Canada Limited - Departure from Generally Accepted Accounting Principles

> Atomic Energy of Canada Limited recorded a current asset of $16.4 million on its balance sheet at 31 March 1988, related to the CANDU 300 power reactor program. The effect of this treatment was to defer pre-project costs incurred during 1987-88 in anticipation of government funding. The recoverability of these costs from government was not assured at 31 March 1988 because parliamentary appropriations had not been approved to reimburse the $16.4 million costs incurred to that date. In these circumstances, generally accepted accounting principles require that these costs be expensed. Had these costs been expensed in 1987-88, net income for that year, and retained earnings at 31 March 1988, would have been reduced by $16.4 million, resulting in a net loss of $6 million for the year.

3.5 During 1987-88, the Corporation expended $16.4 million in the first year of a four-year program currently estimated to cost $109 million in total, for the pre-project engineering of a CANDU 300 power reactor. At year end, Cabinet had authorized the provision of federal funding of $28 million of the initial $45 million to be spent on the program by 31 March 1989, with the remaining $17 million to be provided by a cash contribution by the Corporation. The Corporation's request for funding of the balance of the program remained outstanding. Pending receipt of the approved funding in 1988-89, clarification from the government of the manner in which the Corporation's cash contribution would be made and the government response to the request for further funding, the $16.4 million costs incurred to 31 March 1988 were carried on the balance sheet of Atomic Energy Canada Limited as a current asset.

3.6 Although the Cabinet decision was evidence of an intention to fund, actual funding would not result until the approval of Supplementary Estimates. Further, the Cabinet decision did not indicate that the federal funding of $28 million was to be applied to the costs incurred to 31 March 1988, nor did it indicate when the Corporation must provide its cash contribution.

3.7 With no formal agreement with the government to fund the costs incurred to 31 March 1988, in our opinion it is not appropriate to recognize the government's portion of the funding as at that date. We are of the view that these costs of $16.4 million should have been expensed as incurred. Had this treatment been adopted, Atomic Energy of Canada Limited would have recorded a net loss for the year of $6 million rather than the reported profit of $10.4 million.

3.8 Following discussions with government officials subsequent to the date of our audit report, the Corporation has indicated that it will seek the necessary approvals to have the $16.4 million funded by way of a budgetary appropriation in 1988-89.

Canadian Saltfish Corporation - Activities Beyond the Corporation's Statutory Powers

> During the year ended 31 March 1988 the Canadian Saltfish Corporation authorized loan guarantees on behalf of fish producers and advanced direct loans

to fish producers to assist in the construction, acquisition and refit of fishing vessels. The Corporation also continued its involvement in the sale of frozen fish products and the provision of advances to frozen fish producers. In our opinion, these activities are not within the powers of the Corporation under the Saltfish Act.

3.9 The Canadian Saltfish Corporation was established by the Saltfish Act in 1970 to improve the earnings of the primary producers of cured codfish. The Saltfish Act restricts the Corporation to trading and marketing in cured codfish (salted cod) and its by-products in the Province of Newfoundland and the Lower North Shore of Quebec.

3.10 The Act permits the Corporation to make working capital loans during the fishing season but does not provide the authority for loans or loan guarantees for capital purposes without following the requirements of the Financial Administration Act (the FAA). The FAA permits Crown corporations to make loans and loan guarantees when specific authority has been obtained to do so.

3.11 During 1987-88 the Corporation entered into agreements and arrangements with fish producers to finance the construction, acquisition and refit of fishing vessels, to secure supplies of the larger codfish that would be caught by these vessels. The financing was provided through loan guarantees totalling $3.7 million and direct loans totalling $1.4 million. In addition, the Corporation entered into commitments as of 31 March 1988 to guarantee up to a further $1.2 million in loans, and to advance an additional $500,000. The Corporation did not obtain authority under the FAA prior to entering into these agreements and arrangements.

3.12 The Corporation's financial statements have been qualified since the year ended 31 March 1983 for activities involving sales of frozen fish products. Since 1982-83 these activities have varied from a low of 29 percent to a high of 48 percent of total reported sales. For 1987-88, sales of frozen fish products amounted to $32.4 million, representing 38 percent of total reported sales.

3.13 The Corporation markets frozen fish products under contract with a number of producer companies. Under these contracts, it can provide the producer with immediate cash advances of up to 75 percent of the projected market value of the fish products, with the balance payable determined by the ultimate selling price and related expenses. As we have stated since 1982-83, because the Saltfish Act specifies the Corporation's rights only in relation to cured codfish, sales of frozen fish products and advance payments to frozen fish producers are not within the powers of the Corporation under the Saltfish Act.

3.14 The auditor's report for the year ended 31 March 1988 is therefore qualified for lack of authority to i) issue direct loans and loan guarantees for capital purposes, and ii) participate in frozen fish activities.

Observations on Departmental Operations

Department of Agriculture - Failure of the Agricultural Products Board to Deposit Receipts in the Consolidated Revenue Fund

> In our 1987 Report to Parliament, we reported that the Agricultural Products Board, under its Surplus 1986 Ontario Grapes Program, had used $1 million of proceeds from the sale of grape products for Board expenditures rather than depositing these moneys to the Consolidated Revenue Fund, as legally required. During the year ended 31 March 1988, a further $2 million of revenues from this program was used to pay Board expenditures, and the practice is continuing.

3.15 The Board purchases and sells various agricultural commodities in order to stabilize their prices. Costs of purchasing these commodities and losses on disposing of them are financed, in part, by moneys appropriated by Parliament.

3.16 In our 1987 Report to Parliament, we reported that, as part of the Surplus 1986 Ontario Grapes Program, the Board entered into administrative arrangements that were not in accordance with section 5 of the Agricultural Products Board Act. A bank account was established outside the Consolidated Revenue Fund. This account has been administered in trust by an agent, and all public moneys associated with the Board's Surplus 1986 Ontario Grapes Program have been deposited and disbursed through this account. As a result, $2 million of public money representing proceeds from the sale of grape products in 1987-88, in addition to the $1 million in 1986-87, was not deposited to the Consolidated Revenue Fund. and program costs were not all paid from money appropriated by Parliament, as required by the Board's Act. The use of these revenues to pay program costs is not within the Board's authority, a fact which the Board acknowledges. In order to avoid seeking Treasury Board approval for additional program expenditures, the Board has funded them with a cumulative amount of $3 million of public money.

3.17 In addition, as of 31 March 1988, the Board had incurred losses of $121,000 in excess of the maximum amount authorized by Governor in Council in respect of the Surplus 1986 Ontario Grapes Program. A similar situation existed in respect of the Surplus 1984 Ontario Grapes Program, when the Board, without prior approval, incurred losses of $2.8 million in excess of the maximum amount originally authorized by Governor in Council. Approval for these increased losses for the 1984 program was not received until 20 August 1987.

Department of Agriculture - Inadequate Financial Controls and Records in the Agricultural Stabilization Board

> Significant financial controls were not in place during 1987-88 when payments of $186.8 million were made to producers, and inadequate supporting documentation for these payments was maintained. These deficiencies have been addressed.

3.18 The Agricultural Stabilization Board's objective is to stabilize the returns received by producers, to help the industry realize fair returns for its labour and investment and to maintain a fair relationship between prices received by farmers and the costs of goods and services they buy. To this end, the Board makes deficiency payments directly to producers of some agricultural commodities (generally based on quantities of the commodity marketed by each producer). These deficiency payments amounted to $186.8 million in the year ended 31 March 1988.

3.19 During that year, the Board experienced considerable staff turnover. At the same time it changed, without adequately planning for the changes, many of the systems for calculating and preparing the deficiency payments. These changes involved automating procedures which previously had been performed manually and replacing individual producer declarations with marketing summaries prepared by provincial producer organizations. Significant financial controls were missing when these payments were made, and the Board did not maintain adequate supporting documentation for the payments. For example:

- Certification of marketing information submitted by various provincial producer associations, which often is the basis of these payments, was not received or had been misplaced.
- The Board did not keep adequate control over the recording of and changes to the marketings reported by producer organizations or of other adjustments affecting payments to producers. In fact, it took over four months for the Board to re-create documentation to support some of its 1987-88 deficiency payments.
- The Board maintains many of its detailed records on micro-computers. There was very little control over the recording of, or access to, the computerized data.
- For most of the year, the Board was unable to produce a listing of its accounts receivable on a timely basis. We estimated that some $1.6 million is potentially recoverable against payments made in 1986 and 1987, because producers have not yet complied with the conditions of the payments.

3.20 We also noted that financial officers assigned to the Board by the Department of Agriculture, who were required to monitor and exercise financial control over the Board's disbursements, certified deficiency payments based on inadequate supporting documentation and without performing appropriate procedures to determine the accuracy of the payments. This is contrary to the requirements of Section 26 of the Financial Administration Act.

3.21 In addition, calculations of deficiency payment rates for two commodities were not verified and approved. These rates have since been determined to be in error. The first error resulted in the deficiency payments for one commodity being understated by an aggregate amount of about $580,000. Another error was made in calculating the support price for a second commodity which resulted in no deficiency payments being made, when producers were entitled by statute to receive some $48,000.

3.22 The Board has recognized these weaknesses and has corrected, or is in the process of correcting them. For example, the Board:

- has now received appropriate certification of the information previously submitted by producer organizations and used as the basis for interim payments, and now requires that this be on hand before payments are made for future programs;
- has reconstructed supporting documentation for payments already made, and has implemented controls to ensure that such documentation is safeguarded and that records are maintained for future programs;
- has requested or obtained independent assurance as to the accuracy of the information previously submitted by producer organizations which was used as a basis for payments during 1987-88; and
- has implemented a review and approval process for calculating deficiency rates.

3.23 Finally, the Department of Agriculture has taken steps to ensure that appropriate verification procedures are carried out by financial officers assigned to the Board prior to certification of requisitions for deficiency payments.

Department of the Environment and Department of Public Works - Non-use of Leased Property Still Unresolved After 14 Years

> In 1976, 1977, 1978 and 1984, we reported on rental payments by the Department of the Environment (DOE) for approximately 55 acres of land which, apart from a small sublet portion, were vacant. In 1978, the Public Accounts Committee recommended that either this lease be disposed of or a change in use be negotiated. In 1988, the situation is substantially unchanged.

3.24 The lease dates back to 1974 when, after acquiring an existing leasehold interest at a cost of $4 million, the Department of the Environment entered into a 71-year lease of land from the Squamish Indian Band for the construction of a proposed Pacific Environment Centre in Greater Vancouver. This project was subsequently cancelled.

3.25 During the first 14 years of the lease, the government has paid approximately $12.7 million for lease acquisition, rental and taxes on the land. The rent is adjusted on the basis of an appraisal every five years and is partly offset by the amortized cost of the original leasehold acquisition, as shown in the table below. Valuations and rental payments are as follows:

	1974	1979	1984
Market value as appraised	$ 7,108,637	$ 8,315,000	$ 14,782,086
Rate of return used	8%	8.5%	9%
Annual gross rent	561,491	706,775	1,330,388
Less amortized acquisition cost of leasehold	(320,089)	(320,089)	(320,089)
Annual payment for five-year period	241,402	386,686	1,010,299
Annual rental income from sub-lease credited to the Consolidated Revenue Fund	-	-	215,208
Net Annual Cost	241,402	386,686	795,091

Current annual rent is $1.3 million for this property in Greater Vancouver which has been substantially vacant since the inception of the lease 14 years ago.

3.26 In 1977 and 1984 we commented on the lack of action to resolve this matter. We noted that in 1978 the Public Accounts Committee had recommended that either the lease be disposed of or a change in use be negotiated.

3.27 The Department of the Environment and the Department of Public Works have attempted to resolve this problem. A number of plans and alternatives have been considered over the past several years. However, some 10 years after the Public Accounts Committee recommendation, no firm decision has yet been made by the Government as to how to resolve this matter.

3.28 The Bureau of Real Property Management, which was formed in 1986, is now co-ordinating the efforts of the departments involved to expedite examination of the alternatives and an early resolution of the matter.

3.29 A Treasury Board Submission outlining the alternatives is being prepared for consideration by the participating departments.

Department of Finance - Undisclosed Subsidy to the Saint John Harbour Bridge Authority

> An undisclosed subsidy is being given to the Saint John Harbour Bridge Authority (the Authority) as a result of the operation of a 1966 agreement. The four parties to the agreement are Canada, New Brunswick, the City of Saint John and the Authority. The subsidy is taking the form of debt to Canada, which now amounts to $30 million. Statements made by the Government when the agreement was signed indicated that this debt to Canada would be repaid, whereas it has increased each year.

3.30 An agreement covering the construction of the bridge and funding of the Authority was signed in July 1966 by the four parties. Under it, the federal government financed the construction of the bridge (approximately $18 million) through loans and debentures issued by the Municipal Development and Loan Board and the National Harbours Board (now the Canada Ports Corporation). The agreement requires the Authority to operate the bridge as a toll bridge and provides for the written approval of both Canada and New Brunswick for any toll changes. It also calls for the federal government, through the Minister of Finance, to provide advances to the Authority to make up any annual shortfall between the toll revenues and operating costs and debt service charges. The agreement expires when all the Authority's debt has been repaid, or in the year 2021, whichever comes first.

3.31 When the agreement was entered into, two press releases issued by the Office of the Prime Minister of Canada referred to financing arrangements and to recovery of debts through toll revenues. The first release, in February 1965, explained that: "tolls will be charged on this new bridge and eventually the bridge should become self-supporting". In 1966, when seeking authority from Parliament for moneys to be advanced by Canada, the Minister of Finance informed the House of Commons that: "advances would be recovered in subsequent years when toll revenues become adequate for that purpose".

3.32 However, tolls have not been raised since they were introduced 20 years ago, and the Authority has incurred annual deficits. Moreover, the agreement contains no provision for milestone reviews of revenue sufficiency. All requests by Canada to increase the tolls, the last of which was made in 1982, have been refused by New Brunswick. Consequently, contrary to the original intent of self-sufficiency for the bridge's operations, Canada continues to subsidize the Authority's deficits.

3.33 As of 31 March 1988, total debt to Canada amounted to $30 million (comprising the balance of the loans for the construction of the bridge ($16 million) and the advances to finance the deficits ($14 million). Moreover, because the agreement provides that interest on most of the advances is payable only if the Authority has excess funds available, Canada has not received any interest income on these amounts over the years. To date, this has resulted in foregone revenues of $12 million.

3.34 Unless some action is taken, the Department of Finance has projected that the amount owing to Canada will approximate $85 million by 2021 when the agreement expires. In addition, interest income of over $100 million on the advances will be foregone.

CARS WITH 25¢ EXACT CHANGE OR TOKE

Tolls have not been increased in 20 years (see paragraph 3.32).

3.35 In our opinion, this financing arrangement represents a continuing and ever-increasing subsidy rather than an indebtedness to Canada as originally intended, and should be reported as such to Parliament.

Department of Fisheries and Oceans - Economic and Regional Development Agreements

3.36 At the time of our audit, Economic and Regional Development Agreements for fisheries were operating in three provinces - Nova Scotia, New Brunswick and Prince Edward Island - for a total initial federal commitment of $67.5 million over a five-year period and approximatey 150 projects per year. We examined the operations of projects under the agreements in Nova Scotia and New Brunswick; Prince Edward Island was not included in our scope because of the relatively small size of the agreement. In general we found that there was adequate control over agreements and compliance with conditions and guidelines. There were three exceptions, which are set out in the three following notes.

Department of Fisheries and Oceans - Failure to Deposit Public Moneys in the Consolidated Revenue Fund and Lack of Compliance with Program Authorities

> The Department of Fisheries and Oceans signed a contribution arrangement with a company to assist in the establishment of a salmon demonstration farm. This was a departmental research project to evaluate technologies for salmon farming

and transfer this information to the private sector. In our opinion, this arrangement resulted in the failure to deposit revenue from the sale of salmon obtained from the farm's operations to the Consolidated Revenue Fund. This by-passed normal financial controls and the authority of Parliament, since what should have been public moneys were not deposited to the Consolidated Revenue Fund as required by the Financial Administration Act. Also, the contribution approved by the Department exceeded the limit for individual contributions authorized by Treasury Board by over $900,000.

3.37 A Salmonid Culture Demonstration and Development Farm project authorization was signed in August 1985 for $1.5 million under the Canada-New Brunswick Subsidiary Agreement on Fisheries Development. This project was funded 100 percent by the Department. A contribution arrangement, providing over $1 million in contribution funding plus capital equipment leases, was signed with a company. The Department purchased the land for the farm site from the company and leased the aquaculture rights. Fish were provided by federal hatcheries. An advisory committee was established by the Department to oversee the activities of the farm and a departmental employee served as the farm manager during the first three years of the project. The revenue from fish sales were only to be used to pay the operating costs of the farm, and the company could not sell the salmon without prior approval of the advisory committee.

3.38 In summary, this company has made no contribution to the capital assets of the farm, has limited financial liabilities other than those guaranteed by the Department and has no control over the project. The function of the company was to administer the operation of the farm and the related funds. In return the company was to receive $90,000 for use of its aquaculture rights plus overhead payments which were estimated to be $148,500.

3.39 In our opinion, this project as designed was intended to use the sales proceeds as project funds instead of depositing them as public funds in the Consolidated Revenue Fund. Documentation reviewed showed that the revenue from fish sales was to be deposited in the recipient's corporate account to finance the salmon farm's operating costs in 1988 and subsequent years rather than depositing this revenue in the Consolidated Revenue Fund. This is contrary to the Financial Administration Act. At 31 March 1988 sales of $600,101 had been realized and used as follows: $448,191 was used to reduce contributions due for the year 1987-88 and the balance ($151,910), along with any further revenues from sales, will be used to reduce contributions in 1988-89.

3.40 The terms and conditions for contributions approved by Treasury Board established a limit of $100,000 for demonstration projects. The contribution signed with the recipient provided for contribution payments of over $1 million. While this did not exceed the budget for the resource development component of the Subsidiary Agreement, it exceeded the contribution limit approved by Treasury Board by over $900,000.

3.41 The Department states that it has recognized the administrative weaknesses in the project and has instituted corrective measures with respect to management authorities and procedures. The Department is of the view that this innovative project has made a substantive contribution through technology transfer and assistance to the industry in developing the salmonid aquaculture industry in the Bay of Fundy, which has increased from 5 producers with sales of $600,000 in 1985 to 30 producers with sales of over $20 million in 1987.

Department of Fisheries and Oceans - Circumvention of a Treasury Board Decision

> In March 1987 the Department of Fisheries and Oceans approved a $600,000 contract with the New Brunswick Department of Fisheries to provide services related to a Marine Service Centre on Grand Manan Island, New Brunswick. In substance, however, it was a contribution to the construction costs of the service centre. This was contrary to a Treasury Board decision, as the Province was excluded as an eligible recipient of a contribution for the purposes of the Canada-New Brunswick Subsidiary Agreement on Fisheries Development.

3.42 Before February 1986, there were extended discussions between the Department and the Province of New Brunswick on the joint funding of a Marine Service Centre at Grand Manan. However, on 20 February 1986 Treasury Board rejected a proposed amendment to the New Brunswick Economic and Regional Development Subsidiary Agreement that would have made the Provincial Department of Fisheries an eligible recipient of contributions under the Agreement.

3.43 On 30 March 1987 a project authorization form was signed by the Department to share the construction costs of a Marine Service Centre at Ingalls Head, Grand Manan with the Province of New Brunswick. On the same day, the Department entered into a contract with the provincial Department of Fisheries under the Canada-New Brunswick Subsidiary Agreement on Fisheries Development for the Province "to provide professional services to the project at the Marine Service Centre at Ingalls Head" to meet the Government's intentions related to marine service centres under the Agreement. The total approved costs for the project were $2.7 million, $600,000 being the Department's share. The service centre was to be owned and operated by the Province on land leased to it by the federal government.

3.44 In our opinion, it was improper to use a contract for this project since no goods or services were being rendered to the federal government. Had the Department obtained authorization for the Province to be an eligible recipient, a contribution would have been the appropriate funding procedure.

3.45 The Department states that it recognizes that the use of a contract was inappropriate in this case and has strengthened monitoring and control procedures to avoid a repetition of this isolated problem.

Department of Fisheries and Oceans - Lack of Due Regard for Economy

> Under the Canada-New Brunswick Subsidiary Agreement on Fisheries Development, four of eight New Brunswick-based herring seiners were to be purchased and their quotas redistributed among the remaining four. The vessels were to be sold and the revenues (losses) shared equally between the federal and provincial governments. Ultimately, two vessels were purchased for $1.3

million in September 1985, with the costs shared equally by the two governments. These vessels (appraised at between $1.5 million and $1.9 million), which had a total market value of $800,000 according to an independent appraiser, were then resold in May 1986 for $380,000. In our opinion, the purchase of the vessels did not demonstrate due regard for economy.

3.46 The Community Improvement Corporation was selected as the agent of the Management Committee of the Fisheries Development Subsidiary Committee (with Treasury Board approval) to carry out the purchase of the vessels and their licences and to dispose of the vessels. The Management Committee was a joint committee of the federal and provincial governments. In May 1985 a letter of direction was issued to the Corporation by the Department on behalf of the Management Committee authorizing it to enter into the transactions described, and stating the terms and conditions under which it was to do so. Consistent with Treasury Board direction, the Department's instructions placed considerable emphasis on economy in both the purchase of the vessels and their licences and in the sale of the acquired assets. For the purchase, the instructions were that payments should be "... not less than the salvage value of such vessels and will not exceed, per vessel, the total of $250,000, plus the appraised value of the vessel as established under the Fishing Vessel Insurance Program (FVIP)". The Corporation was further instructed that, "every effort will be made to minimize the cost and maximize the returns on the disposal of the assets pursuant to this agreement".

3.47 FVIP appraised the vessels at $1.9 million. An appraisal conducted by an independent company estimated their value at $1.5 million; however, it advised that the maximum market value that could be expected for the two was $800,000. Both vessels had operated at a loss in the previous two years.

3.48 The vessels and licences were purchased for $1.8 million. This price included the negotiated price of each vessel plus $250,000 – the estimated value of the licences – for each vessel as set out in the instructions to the Corporation. Therefore, the price paid for the vessels was $1.8 million less $500,000, or $1.3 million. The vessels were subsequently sold at arms length through a reasonably conducted public tender process for $380,000. Thus there was a potential excess payment of $910,000. The vessels were not sold as salvage, and we are informed that both are working in another fishery, one as a fishing vessel and the other as a tender.

3.49 In our opinion, this program was not executed with due regard for economy. None of the documentation we reviewed adequately explains the substantial difference between the appraisals of $1.5 million and $1,9 million, and the estimated market value of $800,000, and between the estimated market value of $800,000 and the resale revenue of $380,000. One of the vessels was appraised at $425,000 and $665,000, its market value was assessed at $225,000, and the revenue from its sale was only $30,000.

3.50 We believe the maximum purchase price that should have been considered for these vessels was $800,000, the maximum estimated market value. In fact, the purchase price of the vessels should have been even lower because, as indicated by the independent appraiser and confirmed by the resale value received, the estimated market value did not take into account the depressed state of the fishing industry.

3.51 The Department replies that, as noted, in its instructions to the Community Improvement Corporation (CIC) it stressed economy in carrying out the program. The Department pointed out that CIC acted as an agent of both federal and provincial governments and carried out its responsibilities in accordance with the instructions provided. The question of appraisal values versus market values is not one that can be addressed by the Department although it should be noted that market conditions can vary greatly given the difference of approximately two years between the time of the initial appraisal and the sale of the two vessels.

Department of Regional Industrial Expansion - Failure to Collect Money Owed to the Federal Government

> An event supported in part by $2.3 million in financing by DRIE resulted in a surplus. The federal government's share of this surplus was to be repaid on the basis of its participation in the financing and credited back to the Consolidated Revenue Fund. DRIE's estimate was that $115,000 should have been repaid. Although all conditions for repayment were met, the Corporation involved did not repay the federal share of the surplus, and DRIE did not seek repayment for more than a year.

3.52 In December 1986 the Treasury Board approved the payment of $2.3 million to a non-profit corporation for Rendez-vous 87, a week-long event in Quebec City involving sports and the arts. The $2.3 million was made up of a $1.0 million grant toward the Corporation's operating costs and a $1.3 million contribution for specific activities during the event. This represented the federal share of $9.2 million in planned financing. Financing was also provided by other levels of government, private sector sponsorships and commercial revenues. A specific condition of Treasury Board approval was that any surplus from the event be shared, based on the rate of participation of the parties sharing in the financing, and the federal share of the surplus be credited to the Consolidated Revenue Fund.

3.53 DRIE entered into two contracts with the Corporation which, among other things, specified the arrangements for repayment of surplus funds. Repayment was to take place on receipt by DRIE of a final report and audited financial statements. The contracts specified 30 June 1987 as the latest date for submission of these reports and repayment of any surplus.

3.54 The event took place as scheduled between 8 February and 15 February 1987. All of the $1.0 million grant and 90 percent, or $1.17 million, of the contribution was paid to the Corporation in keeping with the terms of the contracts. The event was successful, and the Corporation's audited financial statements disclosed a surplus of $1.5 million to 31 March 1987. A subsequent audit in September 1987 conducted on behalf of DRIE confirmed the surplus and set the figure at $1.1 million. The final report on the event was published by the Corporation in June 1987 as required.

3.55 DRIE estimated the federal government's share of this surplus to be $245,000. When the 10 percent holdback of $130,000 on the contribution was taken into consideration, DRIE's calculation was that the Corporation should repay $115,000.

3.56 Although all conditions for repayment of the surplus had been met, repayment did not take place, and DRIE did not seek repayment or create an account receivable. The possibility of seeking repayment was considered, but no action was taken. Documentation on file indicated that there were suggestions from the Corporation to leave the federal share of the surplus to be spent on projects in the region rather than repay it to the Consolidated Revenue Fund.

3.57 We are concerned by the lack of action since June 1987 to seek the repayment that was called for in the contracts and was a condition of the approval for federal participation. Good management of public funds would require that prompt action be taken to collect money that is owed to the government.

3.58 In late August 1988, DRIE requested that the Corporation repay the amount of $115,000.

Department of Regional Industrial Expansion - Payment in Advance of Need

> The Department of Regional Industrial Expansion (DRIE) made payments to a shipbuilder on a fixed schedule to assist in financing the construction of a ferry. However, most of the payments were in advance of need for construction and were invested by the shipbuilding company in short-term securities. These securities will earn the shipbuilder over $4.25 million in interest payments to the end of March 1988.

3.59 DRIE entered into an agreement in January 1987 for a repayable contribution of $125 million to facilitate the financing of the construction of the Caribou II, a ferry to be operated by Marine Atlantic on the Newfoundland to Nova Scotia service.

3.60 This agreement provided for payments to be made to the shipbuilder on fixed dates; an unusual provision in the shipbuilding industry which usually operates on a milestone or progress payment basis. Officials at the Department of Regional Industrial Expansion have indicated that the early payment was requested by the shipbuilder and was an integral part of the negotiations regarding construction financing.

3.61 Because the amounts paid were in excess of those required for the ferry construction, the shipbuilder invested the funds in short-term securities to earn interest. In 1987-88, these excess funds ranged from a low of $20 million to over $78 million.

3.62 We estimate that this investment earned the shipbuilder over $4.25 million in interest to the end of March 1988. Additional interest of approximately $1.8 million could be earned by the time the ferry is complete.

3.63 We reviewed DRIE's documentation on the approval process for this project and noted that the arrangement for payment on fixed dates was approved by both Treasury Board and Cabinet. However, this documentation did not disclose the extent to which payments to be made were in advance of the shipbuilder's requirements nor did they disclose any estimate of how much the shipbuilder could earn in interest on these funds.

3.64 Since September 1987, government policy has been that departments identify and justify the borrowing costs associated with advance payments for contributions.

Department of Transport - Lack of Control over Payments to VIA Rail Canada Inc.

> The Department of Transport is unable to determine the proper amounts owed to VIA Rail Canada Inc. at the end of any particular year, and the related expenditures reported in the financial statements of the Government of Canada continue to be misstated. The Department has still not strengthened accounting controls over payments to VIA and resolved a conflict among the Act, regulations and agreements governing these payments.

3.65 **Background.** The Department of Transport makes payments to VIA Rail Canada Inc. under the authority of an appropriation approved by Parliament on an annual basis. These payments fund VIA's capital expenditures and net operating costs. VIA has, in turn, operating agreements with the two national railways, CN and CP, which allow VIA the use of track lines, equipment and personnel in return for the reimbursement of the railways' costs. In addition, labour assistance payments to VIA, CN and CP are made against the same appropriation for costs resulting from changes to the rail passenger program. In 1987-88, the total charges to the appropriation amounted to $604 million.

3.66 **Insufficient review of capital payables.** In 1987, we reported that because of insufficient accounting controls, the Department had overstated its capital payables to VIA at year-end by at least $15 million. During our current examination, we noted that the Department had made little effort to strengthen these controls. Our examination further revealed that, for 1987-88, the Department had established a capital payable to VIA of $36 million without obtaining sufficient and appropriate documentation. Our analysis shows that this liability and the related expenditure are misstated because they include $5.5 million for locomotives, which do not have to be paid for by VIA until February 1989.

3.67 **Inability to determine total operating costs at year-end.** The 1977 Appropriation Act creating VIA stated that it would be reimbursed for its net operating costs, subject to regulations. Some of these costs relate to final invoices from CN and CP. In 1987-88, $4.7 million was paid to VIA and $6.3 million was accrued by the Department toward final invoices for 1985 and 1986 totalling $79 million. As there is no deadline for clearing or finalizing these invoices and since they are subject to audit by the National Transportation

Agency (NTA), the Department cannot determine how much it owes VIA at the end of any particular year. This also results in charging payments against the incorrect year's appropriation and misstating the expenditures reported in the financial statements of the Government of Canada.

3.68 Furthermore, since the regulations provide for the reimbursement of VIA's estimated operating costs, technically the final invoices from CN and CP do not qualify for payment under the regulations.

3.69 The present method of determining amounts payable to VIA should be reviewed to identify a way to establish VIA's net operating costs more accurately and on a more timely basis.

3.70 The Department is currently addressing the issue by drafting amendments to the regulations. Furthermore, VIA, CN and CP have been instructed by the Minister to enter into contracts which reflect the spirit of the draft rail passenger legislation and, to the extent practicable, the concept of fixed price contracts. Consistent with that concept, no NTA audit would be required.

3.71 **Labour assistance payments - failure to establish validity of claims.** In 1986-87, the Department overexpended the appropriation by $9.1 million. The Department attributed this to an unanticipated increase in claims made by CN as a result of the reduced workload at CN's maintenance shops and the transfer of CN maintenance employees to VIA. The Department paid $5.6 million to CN and $100,000 to VIA for charges relating to 1985-86 and established a $10.7 million liability for 1986-87 charges. Steps taken by the Department did not ensure that these were valid claims as defined in the regulations.

3.72 During 1987-88, officials in the Department of Transport and the Department of Justice reviewed the claims and concluded that they did not meet the requirements of the regulations. The Department reversed $10.2 million of the charges it had set up as a liability, but it was too late to reverse the charge against the appropriation. As a result, the expenditures of the Department of Transport were overstated by $5.7 million for 1985-86 and $10.7 million for 1986-87. Such a situation would not have arisen if the Department of Transport had originally ensured that the claims were valid according to the regulations.

3.73 In June 1988, the Treasury Board approved a submission by the Department of Transport aimed at redressing the authority problems in the regulations, and the regulations were amended effective July 1988. The Department is currently seeking Treasury Board approval for a new contribution program which would retroactively provide the authority for paying all the disallowed claims.

WELL-PERFORMING ORGANIZATIONS

WELL-PERFORMING ORGANIZATIONS

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4

WELL-PERFORMING ORGANIZATIONS

Main Points

We examined eight government organizations that are considered to be performing well. We sought to identify and describe the attributes that contribute to this high performance. (paragraphs 4.9 to 4.11)

Emphasis on people. People are challenged, encouraged and developed. They are given power to act and to use their judgment. There is a belief that high performance is a product of people who care rather than systems that constrain. People do not preoccupy themselves with the risk of failure, but are confident they can tackle virtually any challenge. (4.73 to 4.76)

Participative leadership. Leadership is not authoritarian or coercive, but participative whenever possible. The leaders envision an ideal organization, define purpose and goals, then articulate these and foster committment. Staff communicate easily. They feel comfortable consulting their peers as well as those above and below them. Although formal levels exist for administrative purposes, there are no boundaries that inhibit collaboration in achieving goals. (4.77 to 4.80)

Innovative work styles. Staff reflect on their performance. They learn from the effects of their actions. They seek to solve problems creatively. They maintain strong monitoring, feedback and control systems as useful tools. They are self-reliant, rather than dependent on control from an outside authority. (4.81 to 4.84)

Strong client orientation. These organizations focus strongly on their clients, deriving satisfaction from serving the client rather than the bureaucracy. There is an alignment of values and purpose between the well-performing organizations and their political and central agency masters, with a view to strong performance and high achievement. (4.85 to 4.88)

A mindset that seeks optimum performance. People hold values that drive them to always seek improvement in their organization's performance. When conditions change, they adjust their methods, not their values. Because of this orientation toward performance and adaptability, the organization performs well even in a changing environment. This mindset may be the most important attribute of all. (4.91 to 4.96)

WELL-PERFORMING ORGANIZATIONS

Introduction

4.1 In our 1983 annual Report, we published a chapter entitled Constraints to Productive Management in the Public Service. We reported that political priorities had a major impact on productive management; that managers felt unduly constrained by administrative procedures and conflicting accountability requirements; and that there were few incentives, but many disincentives, to managing productively. We suggested that the Government take certain steps: encourage and support productive management; increase managerial authority; emphasize the development of managers; and support experiments to improve productive management.

4.2 That report received widespread attention, both in the public service and elsewhere. It generated inquiry and discussion among public service managers on how to improve productivity; and the Government announced that it would act to remove some of the constraints. As one initiative, the Comptroller General convened a Symposium on Issues in Productive Management, attended by Deputy Ministers, provincial officials and corporate representatives. The Symposium reached a conclusion, among others, that

> There is a need for more innovation and acceptance of risk in the design of management systems and less prescriptive, complex control by the centre...
>
> Policies and systems imposed by central agencies need to be reviewed with considerably more participation by departmental line managers...

4.3 Another initiative, by the Treasury Board Secretariat, was a "Best Practices Exchange Program". It was designed to encourage more productive management.

4.4 The most significant response to our report and to the subsequent Symposium was the Government's adoption in 1986 of a new philosophy of management that relies more on the ability of managers to manage and less on detailed regulations.

4.5 The Government introduced this philosophy as part of a new, ongoing process called *Increased Ministerial Authority and Accountability* (IMAA). Its aim is to remove constraints to productive management, to give departments greater flexibility in allocating resources, and to place greater emphasis on products than on process in program delivery. A key characteristic of IMAA is an invitation for joint initiatives between departments and the Treasury Board. The aim of these initiatives is to improve productive management by trying out new ideas which, if successful, may later be applied throughout the public service.

4.6 This Office supports IMAA as an important step toward a more productive, more satisfied public service. At the same time, we recognize that it takes time to modify the governing values in the public service. Such a modified set of values would complement the traditional focus on systems, controls and processes with an orientation to people, commitment and purpose, both in departments and in central agencies.

4.7 We note that, in the spring of 1988, the Government announced another significant step: the creation of a new Centre for Management Studies to broaden the development of public service managers. This, too, is an important step toward a more productive and more satisfied public service.

4.8 In our 1983 Report, we indicated that some public service managers performed better than others in managing operations productively. They did this largely through innovative thinking and through consultative interaction with bosses, peers, subordinates and central agencies. Their approach generated better performance as well as an *esprit de corps*. We suggested accordingly that this approach should be given strong encouragement and support from corporate leadership and central agencies.

Aim of the Study

4.9 A general consensus indicates that some government organizations continue to perform better than others in delivering their programs productively. They do so not necessarily with respect to any one specific criterion – least cost, for example – but in terms of overall performance, including quality and level of service, timeliness, responsiveness, cost-effectiveness and satisfaction of employees.

4.10 This realization, and the observation that some of these organizations seemed to be using innovative approaches to achieve their level of performance, led us to undertake the present study. Our aim was to discover why some organizations perform well and then to document and report our findings. The expectation was that similar approaches might lead to similar successes in other organizations that are not performing as well. It should be noted that this study was not approached as an audit in a verification mode. It represents an attempt to discover and understand; the evidence we present is qualitative rather than quantitative.

The Study Design

4.11 As the first step in our study design, we sought to identify, by peer consensus, some six to eight organizations that were considered to perform well. We knew that no organization would be perfect, and we didn't look for perfection. To reach a consensus, we interviewed senior officials in various departments and in central agencies.

4.12 Next, we interviewed senior officials of the suggested organizations, obtaining their agreement to participate. During these initial discussions, we also agreed on a focus, or "theme of good performance", on which we would concentrate when examining their organizations. This was important to us, because it would focus our analysis and help us scope out aspects of the organizations to which this particular study didn't relate.

4.13 The next step was to identify and analyze the attribute that produced good performance in the organizations. Was it leadership? Was it autonomy? Was it technology? What attribute or combination of attributes was the basis for success?

4.14 We interviewed people who represented each of the selected areas within the organizations - senior and middle management as well as staff at lower levels. We also interviewed sources outside the organizations, such as suppliers, clients, observers and "owners". By observers we meant overseeing agencies such as, for example, the Office of the Comptroller General. By owners, we meant individuals responsible for overall policy and accountability for the organization. Depending on the organization, this could be a Deputy Minister, a Minister or other Member of Parliament, or a member of a Board of Governors. In addition to conducting interviews, we reviewed various records that were available in the organizations, including surveys of clients and of employees.

4.15 Once we had identified and verified the distinguishing attributes of each well-performing organization, we would determine if some of these attributes existed across all or most of the organizations. If they did, and if it were then possible to document them in a way that would make them useful to other organizations, our aim would be achieved.

Selecting Well-performing Organizations

4.16 The average public servant, indeed the average citizen, hardly needs to be persuaded that at least some government operations work reasonably well. It is possible in Canada to get a passport in a day, to get a driver's licence in an hour, and to contact someone in another part of the world by telephone within a few seconds. In each of these cases, there is at least some government involvement. Yet, when we asked people to name some well-performing public sector organizations, we encountered surprising initial reluctance. Some people maintained outright that there weren't any government organizations that worked well. "They are all bad," someone said. Others thought there might be some, "but they may not remain that way for long." Still others pointed out that there was no solid evidence of good performance; "they may only appear to work well."

4.17 We could not ourselves select the well-performing organizations and then use the study to confirm that they were indeed performing well. We therefore asked a number of senior people in government to suggest organizations that we might include. A helpful source turned out to be the Office of the Comptroller General. That Office's liaison officers knew many departments and programs, based on their work of reviewing and helping to improve management practices. The Treasury Board Secretariat also proved to be a good source of information.

4.18 When we had a peer consensus on about a dozen organizations that were considered to be working well, we stopped the selection process. It would have been possible to identify more, but we couldn't analyze more with the available resources. We then contacted senior officials in the selected organizations and proposed that they participate in our study. One of the conditions for participation was that the organizations be sympathetic to such an undertaking. We believed it would be inadvisable to conduct the study without their agreement and support.

4.19 Most of the organizations readily agreed to participate; some hesitated. In two cases, our Office was in the process of conducting other audit work in the organization, which made it inappropriate to also introduce this study.

4.20 We finally had a list of eight organizations that had agreed to participate. We were now ready to begin the work of trying to identify and document the attributes that helped them perform well.

Eight Participating Organizations

4.21 The selection process yielded a variety of organizations. They are diverse in the kind of work they do, in the type of clients they serve and in size. The largest comprises some 3,000 people; the smallest, less than 30.

4.22 Another diversity is in the nature of the organizations. Three of them are parts of government departments: the Spectrum Management Sector in the Department of Communications; the Bankruptcy Branch in the Department of Consumer and Corporate Affairs; and the Bureau of Labour Information in the Department of Labour. One of the organizations is a Board: the National Parole Board, headed by a chairman. Two are Crown corporations: Canada Mortgage and Housing Corporation and the International Development Research Centre. The Office of the Federal Co-ordinator for the 1988 Olympics was a special government office that existed for only a few years. The last in our study is an ongoing joint project by two government departments: the Property Management Branch of the Royal Canadian Mounted Police and the Department of Public Works.

4.23 We looked at the organizations primarily in terms of those aspects that identified them as well-performing organizations. In three of them, we identified a turnaround situation. Performance had been poor at some point in the past, but had significantly improved and was still considered high. In three other cases, there had been sustained high performance over long periods of time. In another case, performance had been generally high, but direction had varied drastically with changes in demands from government, customers and markets. In the final case, serious initial difficulties were eventually overcome, and the ultimate high performance contrasted favourably with a similar project a dozen years ago in which performance was poor.

4.24 This variety at first raised questions about the possibility of consistent findings. Yet the results of our study showed that even across this diversity there was a distinguishable set of common attributes that generated high performance. Indeed, the diversity that had at first raised concern turned out to be a reinforcing and confirming aspect of the study. Following is a summary description of the eight participating organizations and the focus of our concentration in each.

Canada Mortgage and Housing Corporation (CMHC)

4.25 Our focus in CMHC was on successfully overcoming several major shocks from the environment. In the early 1980s the Government allocated about a billion dollars to CMHC to stimulate the economy through housing starts. This produced growth in the Corporation. Later, the Alberta housing market collapsed, due to the world oil crisis and the subsequent decline of the National Energy Program. This necessitated significant reallocation and adjustment of resources in CMHC. In 1984 the Government directed that much of the Corporation's work be done through provincial housing authorities, which meant a reduction in the scope of its programs. This, combined with a government policy of downsizing and with productivity drives in CMHC, reduced staff from 4,000 to 3,000 people.

4.26 CMHC's high performance during this period of changing requirements was based on clear policies, a strong sense of mission and purpose, continuity in management and staff, a pronounced focus on clients, and open communication, collaboration and consultation at all levels in the Corporation. See Exhibit 4.1.

National Parole Board (NPB)

4.27 In NPB we focussed on management's effort in aligning people's efforts through organizational mission, values and strategy. In the early 1980s, the National Parole Board interpreted its mandate through a statement of the philosophy and principles of parole and a related set of standards and values. However, by 1986 the National Parole Board was characterized by defensiveness. This was in response to adverse public reaction to the release of some prisoners. Also, a number of court decisions, mostly based on the Charter of Rights and Freedoms, challenged the Board's proceedings and policies. Over the next two years there were new initiatives to clarify the Board's mission and values. There were also strong efforts to introduce strategic planning. As a result, in l988 the National Parole Board is confident that it makes a valuable contribution to the criminal justice system. A feeling of pride and purpose has been built over time throughout the organization. See Exhibit 4.2.

Spectrum Management Sector

4.28 Our focus in the Spectrum Management Sector was on using communication, consultation and technology to manage a limited natural resource with limited human resources. The challenges of the Spectrum Management Sector are many. Radio frequencies are public property. Many users compete for them, particularly in metropolitan areas. Radio frequencies have to be allocated and managed carefully to prevent interference and to ensure reliable utilization. See Exhibit 4.3.

4.29 The continued high performance of the Sector is based on open communication and consultation within the Sector, and on a strong orientation toward the client. Staff take pride in meeting challenges as problem solvers with a clear sense of mission. High performance is also due to the organization's extensive use of new technology, such as computers and information systems.

Exhibit 4.1

CLIENT ORIENTATION AND RELIANCE ON PEOPLE IN CMHC

During our study, we discussed the organizations with people who have an outside vantage point. In the case of Canada Mortgage and Housing, this included the Director of a Social Services agency as a client, an architect as a supplier, and the Minister as the "owner".

The Director of the Social Services agency – located on the West coast – spoke of CMHC's remarkable client orientation. "We put up this five million dollar building, and we knew nothing about it, but they guided us through it," he said. "I've always lived in apartments where superintendents change your light bulb. I've never built anything in my life. And I built that building. Once you get involved with CMHC," he explained, "you cannot fail. They teach you, they help you, and they run interference for you. They will not let you fail."

This client also gave his view of CMHC internal behaviour. "There are no secrets. They introduce their new people, and they keep each other informed. When you call, you don't go through four or five levels. Even the person who answers the phone knows what's going on. There's always somebody who knows. They are highly committed people, both to us and to each other."

. . .

The Minister responsible for CMHC echoed the view that performance is primarily a function of staff. "It's all people," he insisted, "and we must make sure that the deputy ministers and presidents who are in place are the appropriate people. They have to be able to engender a spirit of co-operation, but also of purpose." In the case of CMHC, "I have a lot of respect for their performance, especially for their facility for compromise with the Provinces. There is very little advice coming from them that I reject. They believe in what they are doing, and they are proud of it."

. . .

We asked an architect with his own practice, a supplier of services to CMHC, what attracts good people. "I believe it has to start off with a purpose, and with a set of enlightened policies and guidelines," he suggested. "For example, when CMHC was given the policy to deliver housing to people in need, it was amazing what kind of people that attracted. It couldn't have happened by chance. I remember, because I worked with them. I remember we were slaving night and day. It attracted a whole bunch of people who had a vision and said, 'We can put those policies into action.' Enlightened policies attract enlightened people."

Two attributes stand out here: the strong commitment and dedication to serve clients, and the strong reliance on the organization's own staff. This corresponds to the dual orientation of other successful contemporary organizations: they have both an external and an internal focus on people. The vignette also gives one insider's view of what attracts the kind of people such organizations seek: "Enlightened policies attract enlightened people."

Exhibit 4.2

LEADERSHIP AND VALUES IN THE NPB

The National Parole Board is subject to intense media attention and strong public reaction whenever a Parole decision is thought to be too lenient, and especially when a released prisoner commits a crime. One of the crucial functions of the Parole Board is therefore the management of risk.

In 1986, a newly appointed Chairman set out to clarify the Board's mission and values, and to delineate a set of objectives as part of a strategic planning effort. He visited the Board's offices across the country to invite discussion of steps that might be taken. "Many of the people I visited told me that we wouldn't be able to agree on things," the Chairman relates. "Yet, when I reviewed my notes after all the discussions, there were about a dozen items on which everybody agreed." Working sessions and more discussions were held, and with the participation of the Board's staff, a revised statement of mission and values was developed and accepted.

The Board wanted to focus its energies in the areas of highest priority. To do so, it created an "intellectual playground", a framework of strategic objectives within which all of its activities would take place. This sent a message to all staff that they had both the freedom and the responsibility to create appropriate work plans for activities within the strategic framework. The impact was a redirection and focussing of creative energies toward the accomplishment of the Board's mission.

Both the mission and values statement and the strategic planning framework have touched every aspect of the Board's working environment. They have contributed to an organization that has a feeling of pride and purpose, and that is professional, participatory and open.

The kind of leadership illustrated here is not the harsh and austere control-oriented type that demands unconditional compliance with standard rules and regulations. Rather, it is creative, inviting and participative. It is able to articulate purpose, mission and strategy. It seeks to create a climate in which people can feel they are making a valuable contribution to worthwhile objectives.

RCMP/DPW Joint Projects

4.30 Here, we concentrated on successful management of a partnership in RCMP's real property management function. Frequently, interdepartmental efforts are marked by professional jealousies, bureaucratic delays and poor results. In this case, the relationship between the Property Management Branch of the RCMP and the Department of Public Works functions well. Its characteristics seem to be a clear understanding of their respective roles, a strong commitment to "making it work", and the absence of competition for power, prominence or control. See Exhibit 4.4.

Exhibit 4.3

PROBLEM SOLVING IN THE SPECTRUM MANAGEMENT SECTOR

Staff in the Spectrum Management Sector view each other as professionals, as people who are able to solve problems. This culture of professionalism and problem solving is a source of pride in the organization. It is also a source of service and productivity.

Because of the technical nature of the work, it is relatively easy to know when and where a problem occurs. It is not always easy to know how to solve it. "When somebody has a problem that's unique," a staff member points out, "they can turn around and talk to anybody in the organization easily. The organizational climate supports that communication and the technology facilitates it. They'll consult with their colleagues in other parts of the country."

The Sector has rules, as all organizations do. But when there is a consensus that a better solution is available, it's OK to override the rules. "And when there is no time to reach consensus but I'm confident I can get it, I'll solve the problem my way." They would never say, "I'm following the rules. I can't solve the problem." Someone else elaborates: "I'll do the sensible thing because I understand the overall objectives of the organization and I understand what the people above me are going to be thinking about this and what considerations they'll have in mind. That's our culture, and it is the kind of thing that feeds on itself."

We interviewed the Deputy Minister as the person ultimately accountable for the Sector and asked him about the importance of systems as compared to the importance of people in doing the Sector's work: "It is very helpful to use technology as much as possible," he remarked, "because it allows better performance. But the most important factor in spectrum management is the quality of the people. Technology is very useful, but it can't be a master. I cannot underscore that enough."

The attribute that stands out in the Spectrum Management Sector is productive problem solving. Also illustrated is another aspect of the Sector's culture: the willingness to override rules when circumstances warrant it. Technology is seen as helpful and important, but not as a master. The most important factor in the Sector's work is considered to be the quality of its people.

International Development Research Centre (IDRC)

4.31 We looked at IDRC from the point of view of its internationally recognized high performance in delivering research assistance to developing nations. IDRC is considered worldwide to be one of the best organizations of its kind. Its high performance is based on a number of elements: people who are competent, committed and value-driven; continuity of leadership; a clear and strong sense of mission and purpose; a strong client focus; autonomy and flexibility at all levels; risk-taking and innovation; freedom from political and central agency interference; tailor-made internal regulations and reporting requirements; and continual self-scrutiny of strategies and activities. See Exhibit 4.5.

Exhibit 4.4

COMMUNICATION AND COMMITMENT IN THE RCMP

The Royal Canadian Mounted Police maintains several thousand buildings across Canada. It also has an ongoing construction program. Public Works Canada serves as the central service agency that manages the construction of most new buildings.

The relationship between the two departments works well. A senior Public Works official has observed that "the RCMP might be called the model of a knowledgeable client". As a result, the RCMP has the reputation for having its construction projects completed on time, within budget and to standards of quality.

In the early 1970s, the RCMP fully accepted the policy that Public Works would be the centre for architectural and engineering expertise. The RCMP therefore did not retain its own architects and engineers. Each department respects the other's responsibilities, and neither tries to usurp the other's role. During our study, we noted a strong commitment to making the relationship work. Disagreements do arise, but are usually resolved without serious problems.

The RCMP makes specific efforts that contribute to the success of the relationship. For many of its buildings, it uses standard designs that have been developed together with Public Works. The RCMP maintains a ten-year capital construction plan and informs Public Works of changes as they are made. It has a centralized control structure and responds to requests for decisions quickly and effectively. RCMP staff have strong corporate loyalty, which tends to override divisional preferences. Periodic conferences ensure that RCMP property managers maintain common understanding of real property capabilities and needs in the RCMP. Also, managers in the RCMP pride themselves on complying closely with Treasury Board and other central agency policies and regulations. A senior Treasury Board official put it this way: "They honour the rules, and you can trust them to do what they say they will do."

The relationship between the Royal Canadian Mounted Police and Public Works Canada illustrates that joint projects can work well if both parties are committed to making it work. It also illustrates that frequent and effective communication is an important ingredient of good performance. Thirdly, it shows that respect for well-defined roles contributes to success.

The RCMP's Property Management Branch is an example of an operation that lends itself to being managed largely through standard procedures. RCMP management has recognized this and has "routinized" the Branch to the extent that it is possible. It is thereby displaying the attribute of the "intelligent" organization – using a process of developing a set of operational procedures that works best for its purposes and circumstances.

Exhibit 4.5

PARTNERSHIP AND CARING IN IDRC

The International Development Research Centre has found that assistance to developing countries is most effective when it is based on a caring, co-operative partnership. An approach based either on charity or on control is not as effective.

IDRC's operations reflect that insight. Its Board of 21 governors includes members from Third World countries. Its six Regional Offices are operated by people who either are natives of the countries being served or are thoroughly familiar with local language, culture and environment. Recipients of IDRC research funding are aware at all times that "this is our own project; we are responsible for searching out solutions that will solve our problems." They know that IDRC will go all out to assist, but it will not manage, let alone dominate, the research it funds. This sense of local ownership extends all the way to villages, farmers and fishermen outside the research stations.

As part of our study, we visited a number of IDRC research projects abroad. In a tiny settlement in North Eastern Thailand, eight families of "ground-nut" farmers participate in a project conducted by a team of researchers of Khon Kaen University with assistance from IDRC. The purpose of the project is to mechanize the labour-intensive process of ground-nut production. The research team takes as much care to establish a productive partnership with the farmers, and to respect their culture, as it does to foster the research project itself. The team includes assistants who speak the local dialect. One of them explains: "Above all, the farmers have to believe that they can do this without us. They have to see with their own eyes that the new methods can work better for them than traditional methods. Only then will they continue to use them after we have left. In the same way, we researchers have to believe that we can be successful without constant IDRC hand-holding. The idea is to create caring partnerships in development."

At another IDRC project, in Kuala Lumpur, Malaysia, we noted similar values. "Our research officers," explains the regional director, "do not behave as if they are the boss. They seek to establish relationships in which all who are involved will get a sense of ownership and pride. We try to build caring partnerships that ensure success."

Observes another director: "In the same way, IDRC empowers its own employees. Within an overall framework, they are given the right to do things."

Several attributes are embedded in this excerpt of IDRC operations. The vignette illustrates the attributes of caring for people and of empowering people, both within and outside the organization. We note that staff are interested in the research project itself. But they are concerned as much – perhaps more – about the people who participate in the research and who will be working with the research results. IDRC staff know that systems, structure and controls are necessary, but that people's attitudes and values are crucial, because only people can make these tools come alive and productive. The vignette also illustrates the strong sense of client orientation that IDRC staff demonstrate. In addition, the organization itself has a powerful client focus, as shown by the fact that its Board of Governors is of international composition and therefore representative of client needs and preferences.

Bankruptcy Branch

4.32 Our focus in the Bankruptcy Branch was on a turnaround in which people have adapted creatively to do more work with fewer resources. In 1984 the Branch was dispirited from dealing with continuing resource cuts in the face of increasing workloads. While the Branch became more "efficient", processing more bankruptcies per staff member per year, the quality of supervision of the bankruptcy system was low, and many statutory duties were performed only infrequently.

4.33 By l988 the Branch had achieved a turnaround. The quality of its work was much higher; the product had been enhanced; and morale had greatly improved. Standards were more uniform and there was greater overall productivity. The bases for this achievement were enlightened, inspired and participative leadership; considerable investment in the development of people, with parallel investments in technology; and a strong orientation toward clients. In addition, Branch managers displayed resourcefulness and creativity in negotiating special arrangements within the Department and with other departments. See Exhibit 4.6.

Bureau of Labour Information

4.34 The Bureau of Labour Information is the product of a successful transition, from a traditional data collection and publication activity to a service that is strongly client-oriented. Our focus in this organization was on the way it put top priority on client needs.

4.35 Providing information on wage settlements and other contract provisions was part of the Department's mandate when it was established in 1901. However, the sections administering that responsibility have not always enjoyed a sense of accomplishment. For example, during the early 1980s, this area comprised three separate branches, each with a different responsibility, and clients had difficulty knowing where to turn for which service. At the same time, some of their activities focussed on information products that were no longer required by clients.

4.36 By April 1987, however, the Bureau had established a single, clear mission for its activities, namely identifying its clients and continually striving to meet their needs. It set out a strategy of focussed product design and delivery. It discontinued non-essential research and survey activities. It revised its structure to meet the new focus, moving staff from the predecessor branches to the new functions and building staff support for the new organizational culture, geared toward serving clients.

4.37 The Bureau of Labour Information is now considered a well-performing organization. The number of client requests it fills has risen by over a hundred percent; yet it operates with about forty percent fewer staff than before. See Exhibit 4.6.

Exhibit 4.6

DEVELOPING AND EMPOWERING PEOPLE: BANKRUPTCY BRANCH AND BUREAU OF LABOUR INFORMATION

These two organizations illustrate particularly well how efforts to develop and empower their people improved service and satisfaction.

In the early 1980s, the Bankruptcy Branch faced increased workload with reduced resources. More work was being done, but at reduced quality and without a clear sense of direction. Morale and motivation were low. In early 1984, Branch management initiated an intense process of self-scrutiny and realized that the Branch had ceased to do the job it was supposed to be doing.

The resulting resolution was, "We must get back to doing the basic tasks, and we must give our people an appreciation of the value of their role." The Branch redesigned its work and invested significantly in training and developing its employees. This led to improved competence, to better service and to greater satisfaction in doing a good job.

The renewal process was participative, yet it was shaped by a vision: focus on major clients, restructure the Branch's work and help people do a more productive and satisfying job. "Our first commitment was to our people, in the form of upgrading their skills," said the Deputy Superintendent. "The more we invest in them and the more we affirm them as professionals, the more they will act professionally. We help people to be successful. We're not doing anything fancy, but we do it."

* * *

In early 1987, the Bureau of Labour Information was created from three former branches. The vision was to first define an ideal organization and then work toward becoming that ideal. One part of the vision was client focus, product design and the Bureau's structure. The other was organizational culture and the matching of people to jobs.

The people of the Bureau were brought into the new process from the outset. During the 1986 three-day "founding conference" for all staff, the Deputy Minister noted, "We have the potential, we have the product and we have the will. Above all, we have the people – you: qualified, adaptable, ready to serve, and not afraid to discover new ways of doing things."

The Bureau's performance matches these words. Since April 1987, the number of client requests it serves has more than doubled, yet it operates with 39 percent fewer staff than its combined three predecessor branches.

These two examples illustrate a number of attributes of the well-performing organizations. They develop and empower their people, and they focus on client needs to ensure relevance. This has led to a better quality of service and to employee satisfaction. The organizations also reflect on their successes and failures, and they learn from their actions in order to confirm or re-establish direction. They have established an "ideal" to which they are trying to become ever closer.

Office of the Federal Co-ordinator for the 1988 Olympics

4.38 We hesitated somewhat before including this project in our study. Arranging Olympic Games is something unusual, not often done by government. We were persuaded to include the project because it was a significant one-time project, delivered on time and within budget and avoiding political embarrassments. This was in stark contrast to the Olympics of 1976.

4.39 The objectives for the Office of the Federal Co-ordinator for the 1988 Olympics included constructing Canada Olympic Park; contributing to construction of the speed skating oval and the Saddledome; planning of and contributing to "Celebration 88"; representing Canada on the Board of the Olympic Organizing Committee and providing operational assistance; and assuring legacies for Canadian amateur sport. One obstacle to be overcome was the large number of negotiating partners: the City of Calgary, the Province of Alberta, the Olympic Committee and numerous private sponsors. Other challenges were intense media attention, perceived mistrust of the federal government in Alberta and an immovable deadline.

4.40 The Office produced some well-known achievements: projects were on time and within budget; the games were "happy" and largely incident-free; there is a legacy of world-class facilities, with an Endowment Fund to support their future operation; and there is a successful precedent for future funding of similar projects. The bases for these achievements were a clear mission and congruent goals at the political and public service levels. There was political motivation, strong support from central agencies and a collaborative partnership approach among the negotiating partners. See Exhibit 4.7.

Moving Beyond Bureaucracy

4.41 When we considered our findings, we reached an overall conclusion: the well-performing organizations have been able to move "beyond bureaucracy". One may say that they have moved from being public bureaucracies to being public enterprises, if we construe the term bureaucracy to mean red tape and unresponsiveness, and if we characterize public enterprise by innovation, responsiveness and productivity.

4.42 Bureaucracies tend to make their activities routine and predictable, basing their operations on standardized rules. They also tend to set up controls that seek to ensure compliance with these rules. However, the demands of customers frequently change, requiring the very flexibility and innovation that have been standardized out of the bureaucracy's operations. Because of this conflict, there tends to be a gap of unresponsiveness between a bureaucracy and the people it is to serve. Furthermore, a bureaucracy tends to frustrate efforts by its own staff to break out of this framework of inertia. It tends to meet challenges to its own inflexibility by tightening its rules. Typically, the insight that rigidity may be counterproductive does not occur to it.

4.43 Bureaucratic rules pose a dilemma. They are implemented with the best of intentions: to ensure uniform service and to prevent unacceptable performance by those managers and workers who may be poorly trained or unethical. In doing so, they ensure a

Exhibit 4.7

STRONG SUPPORT BY OWNERS: OFFICE OF THE FEDERAL CO-ORDINATOR FOR THE 1988 OLYMPIC WINTER GAMES

In our 1983 study on Constraints to Productive Management, we emphasized the importance of political support. We included a quotation from a senior public servant who spoke of the need for a management philosophy "adopted at the Cabinet level and supported by political leaders (that) communicates to managers what they are expected to do and provides a common understanding between politicians and management." A shared commitment proved its value in the success of the 1988 Winter Olympic Games.

The challenges faced by the Office of the Federal Co-ordinator included an immovable deadline, intense media attention and many negotiating partners. Initially, there was also a fear of repeating the financial debacle of the Montreal Olympics. Meeting these challenges would be a significant accomplishment. The Olympic Games would be an opportunity for a lot of "good news" if they went well.

Once the commitment to proceed was firm, there was strong support in the form of "political will". The Minister of State for Fitness and Amateur Sport provided consistent backing while not interfering with the day-to-day processes. In general, all Ministers, specifically the Minister of Public Works, were willing to take whatever action was necessary at the political level to help the project succeed.

Related Deputy Ministers, including those at key central agencies, reflected the high degree of ministerial interest. Through formal and informal links they helped ensure that the project did not encounter bureaucratic delays. "Having that kind of support," noted one official, "gives you a great feeling of confidence, especially when you seek central agency co-operation and approval."

This congruence of values and interests resulted in a commitment that played an important positive role in the performance of the Office of the Federal Co-ordinator for the 1988 Winter Olympic Games.

Organizational performance is positively influenced when there is strong goal congruence between personal values and organizational needs. It is particularly strengthened when the "owners" – in this case officials at the political level – actively support the organization and its mission, without getting involved in day-to-day management issues.

minimum standard of managerial performance. However, the rules also act as constraints. They inhibit exceptional performance by managers and workers who are skilled and innovative. In this respect, they tend to prevent excellence.

4.44 In our 1983 study on Constraints to Productive Management, we discussed inherent attributes of bureaucracies. Some of these attributes act internally. Bureaucratic managers tend to focus on following regulations, on monitoring compliance and on controlling. They tend not to listen to workers and not to remove roadblocks that constrain workers' performance. Such organizations alienate their workers.

4.45 Similarly, there are attributes of bureaucracy that act externally. Staff in bureaucracies tend to be unresponsive to the needs of customers because they focus on regulations, on fulfilling quotas and on avoiding risks. They tend not to listen to customers' suggestions, and not to help them. They alienate their customers.

4.46 This kind of bureaucratic behaviour is the result of a tacit assumption that systems are more important than people. It is also based on an assumption that systems and regulations can deal with all problems adequately, if only workers will comply with them. Bureaucratic controls are therefore designed to make workers follow prescribed procedures, with little room for initiative, flexibility and innovation. The bureaucratic mindset tends to see problems essentially as problems of compliance.

4.47 Yet we know from experience that problems do find their way up to various management levels precisely because they cannot be solved by existing routines. They don't fit standard procedures and therefore need specialized handling.

4.48 This points out the key difference between controlling and managing. The aim of controlling is to construct systems that will handle all problems in standard ways – "keeping things under control" – within a given framework. In contrast, the aim of managing is to reflect, to act with insight, even to construct a new framework if necessary. Managers and their people must be interpreters and intelligent mediators between an uncertain, unpredictable environment on the one hand, and the operations and capabilities of their organization on the other.

4.49 The strength of organizations lies partly in their ability to "routinize" what should be routinized. However, it also lies in their ability to deal with problems that are beyond routine, for which people must create new solutions. The extent to which an organization is able to deal successfully with unusual problems through innovation and flexibility is a measure of this strength.

4.50 The challenge for designers of organizations and of work itself, therefore, is to not rely on controls exclusively. It is to design organizational structure and job content in such a way that controls are seen as useful tools, and that people can commit to the achievement of worthwhile organizational objectives.

4.51 Our study showed that the well-performing organizations have been largely successful in doing this. Where ineffective bureaucracies focus mainly on controls and constraints, the well-performing organizations focus on people. They challenge, empower and develop their people, they communicate effectively with them, and they open the way for them to become and remain successful at work. The well-performing organizations seem to have been able to combine the needs of the organization with the needs and desires of their people. They have made a shift from control to commitment.

Reliance on People Ensures Productive Relationships; Control Systems Provide "Hard Edges"

4.52 Managers were unanimous when we asked to what they attributed the success of their organizations. They answered that it was due to their people. At the end of an interview, we would ask a senior manager two questions. First: "If you were moved to a particularly complex and difficult job, say to run the mail service, do you think you could do as well?" The answer was typically hesitant and uncertain: "Hmmm ... I'm not sure ... certainly it would take me a while ..." The second question was: "If we were to assign the work to you and your people, could you do as well as you're doing now?" The answer came without hesitation: "To me and my people? Yes. We would find a way to do it as well!"

4.53 The reader might conclude at this point that the well-performing organizations rely for their success only on people and on relationships. That is not the case. Their reliance on people is balanced by reliance on measurement and control systems, which provide the "hard edges" to their operations.

4.54 Measurement and reporting systems enable managers to review and analyze how resources are spent and what results have been achieved. This is important for their accountability and stewardship function. Such systems also enable managers to learn from the past for the future, which is an important aspect of improving performance over time. Our study showed that the well-performing organizations were doing well on both counts.

4.55 In process-oriented organizations, control systems are typically designed to monitor individual actions and processes, rather than results and effects. This prompts staff to concentrate on complying with rules and on pursuing process rather than product. Staff also spend considerable creativity and energy in making themselves look good in the context of these control systems – energy that is not spent on the job itself. In contrast, the well-performing organizations typically perform as a team and focus their systems on results to be achieved. They have moved in the direction of letting product triumph over process.

Encouraging Risk-taking to Accomplish the Task

4.56 A strong focus on product sometimes gives the appearance that regulations are disregarded. In our well-performing organizations we noted that the letter of the rule is indeed sometimes open to interpretation, but the spirit is not violated.

4.57 Traditional bureaucracies emphasize adherence to rules and regulations. If the process is well-controlled, they reason, good results will follow, and the organization will be looked upon favourably. Yet it is a matter of common experience that following regulations does not necessarily lead to optimal results. Some bureaucratic managers are satisfied to follow all the rules, even though results may be lacking. Indeed, they sometimes use compliance with rules as an excuse for not achieving quality and timely results.

Exhibit 4.8

REFLECTIVE SELF-SCRUTINY IN CMHC AND IDRC

In 1984, Canada Mortgage and Housing was directed to offer delivery of its Social Housing programs to provincial housing authorities. At issue were a large number of programs and widely varying attitudes as to how they should be delivered. The Corporation started an intensive negotiation process with a view to signing operating agreements with all the provinces.

Internally, CMHC continually scrutinized its operations to reflect on process and achievement. A group comprising members from all affected areas of the Corporation – Programs, Policy, Financial, Legal, etc. – met early every morning to review progress, discuss issues and assign tasks. This team approach made it possible to manage all aspects of the negotiations.

Minutes were kept of all meetings, and at one point the group celebrated its 100th morning session. When the negotiations were concluded after almost a year, the Corporation awarded the group its "Helping-To-House-Canadians-Award", recognizing successful completion of this arduous task.

* * *

The International Development Research Centre has a strategy of continual self-scrutiny. "Nobody is allowed to become too cozy and comfortable," says its President. Part of that strategy is to have the Board annually review and re-appoint senior officers within IDRC, based on the respect they have earned in the Third World for their contribution to being "partners in research and development".

IDRC undertook a particularly significant self-examination in 1986. Over an intense ten-week period, the Centre reassessed its strategy, direction and operations.

"This top management exercise was painful at times," says one of the participants. "There were long periods of anxiety, particularly because the President made it clear he wasn't going to 'run the show'." He also wasn't going to bring in consultants who would prescribe what should be done. As a result of that process, several working groups were formed, which included employees from all levels. The issues they discussed included decentralization, communications, computers, training and overhead – all in the context of requirements of developing countries and IDRC's mandate to help.

People in IDRC are still inspired about this self-analysis, its positive results and the regained momentum it created. "In the end, the organization gained much more than it thought it would," concluded one of the senior participants. "There is a renewed mission statement, and a renewed strong awareness of courageous leadership."

This vignette illustrates the attribute of strong organizational self-scrutiny and reflection. The practice of carrying out this scrutiny in-house, rather than having it done by outside consultants, and not directed from the top down but by the organization's own staff, also illustrates the attribute of enlightened and committed leadership. Furthermore, these practices of CMHC and IDRC illustrate attributes of organizations that communicate. As well, attributes of the "intelligent" organization are apparent from the description. People review, consult and collaborate as a matter of course on difficult issues. And they exercise self-control rather than waiting to be controlled by events or by outsiders. Lastly we see how, in the case of the CMHC award and the renewed IDRC mission statement, the organizations find ways to put abstract concepts into concrete terms, making them visible and explicit.

4.58 The well-performing organizations emphasize results, yet they still adhere to a justifiable process. They encourage risk taking. They are willing to try new methods when common sense dictates that better results can be achieved by following the spirit of a regulation, instead of the letter. However, staff must hold the values of stewardship, service and results, and they must consult with each other. When their people are governed by these values, the well-performing organizations encourage risk taking as a matter of strategy.

Shifting from Control to Commitment

4.59 In traditional bureaucratic hierarchies, the aim of management is to define the one best way to do a job, to set standards and procedures accordingly, and then to monitor and control people to ensure that they comply with these standards and procedures. This is commonly known as a rational systems approach.

4.60 This approach to job design and control results in significant efficiency improvements when work is routine, repetitive and predictable; it may also extract a cost in human satisfaction. Assembly lines and "sweatshop" operations are examples. However, when work is done under conditions of uncertainty, complexity, rapid change, and a high degree of interdependency, the rational systems approach loses much of its effectiveness. Even when complexity is not a constraint to developing detailed procedures, time may be. For example, by the time a detailed procedures manual is developed, tested and distributed, the situation in the field has often changed, making the manual obsolete even before it is issued. Thus, complexity and rapid change mitigate against the idea of separating the design of work from its execution.

4.61 Traditionally, business schools and text books have based their approaches to improved performance on the following model:

> The world is messy. Yet, to manage well, things need to be orderly, predictable and certain. Therefore, we will create an orderly, predictable and certain world. And then it will be possible to have effective managers and high-performing organizations.

4.62 This model is becoming outdated for the reasons outlined above. It is losing its effectiveness with respect to productivity and performance. In many cases it creates situations where people spend much of their time and energy to "beat the system".

4.63 The well-performing organizations seem to have shifted toward a new model, which might be stated as follows:

> The world is messy. Hence, to manage well, we need to develop managers who can perform productively in work environments that are messy, uncertain and changing. And then it will be possible to have high-performing organizations.

4.64 To implement this new model, the organizations we examined have moved from control to commitment. Their leaders envision goals, describe values and articulate purposes in such a way that people can support and commit themselves to the overall direction of the organization. Managers focus on vision, purpose and goals instead of on mindless compliance with rules and controls. They discourage bureaucratic behaviour; instead, they recognize and reward productive achievement of the organization's purposes.

4.65 Similarly, we found that the staff in the well-performing organization have a clear sense of mission. There is a feeling of ownership, of shared values and a common vision. This team spirit seems to be a key ingredient of the organization's culture.

4.66 One of our interviewees illustrated the concept by analogy. A mechanistic bureaucracy, he said, operates like a conventional gun whose bullets are "blind". They mindlessly follow a set course, because any guiding intelligence is disconnected the instant they leave the barrel. The gun in effect tells the bullets: "Do as I have told you."

4.67 In contrast, the well-performing organization operates like a guided missile system. The missiles are sent by the station, but guided by the target. They have built-in intelligence and are urged to use it. The station in effect tells the missiles: "Lock on to the target and do your best to reach it."

4.68 In the gun analogy, actions are based on compliance; in the missile analogy, on judgment.

4.69 Correspondingly, in the well-performing organizations, purpose and direction are not restricted to policies and procedures. They reside largely in people's values and commitment.

4.70 The effect is that the organizations can virtually be put on "automatic pilot". People know what is wanted, they are committed to it and they perform accordingly. The shift from control to commitment has been achieved.

Common Attributes of the Participating Organizations

4.71 Our study included interviews and observations at various levels of each participating organization and we spoke with people both at headquarters and in the field. It also included discussions with knowledgeable outside people. We talked with suppliers, clients, boards of governors, Deputy Ministers and Ministers. As we collected data, we reviewed and analyzed them to identify those attributes that seemed to be common to all or most of the participating organizations. During feedback sessions with people in the organizations, we discussed the set of attributes we were developing, and confirmed and refined them. We have illustrated some of the attributes in the various exhibits that are included in this chapter.

4.72 Following, in summary form, is a set of twelve attributes that we found to be common to the organizations we examined. They are grouped in four categories: Emphasis on

People, Participative Leadership, Innovative Work Styles, and Strong Client Orientation. Some of the attributes overlap, yet they are distinct enough to warrant individual reference.

Emphasis on People

4.73 The most striking attribute of the well-performing organizations is the emphasis they place on their people. People are challenged, encouraged and developed. They are given power to act and to use their judgment. There is a "caring" attitude in these organizations, based on the belief that, in the long run, high performance is a product of people who care rather than of systems that constrain. Typically, people in these organizations do not preoccupy themselves with the risk of failure, but instead are confident that they can tackle virtually any challenge.

4.74 **The empowering organization.** Well-performing organizations become and remain that way by developing and empowering their people. People are challenged, stretched and encouraged to grow by being given authority, responsibility and autonomy. They are given the power to act, to make decisions and to represent the organization based on their own best judgment. One of our interviewees put it this way: "People work not only with their hands, but also with their minds and their hearts." For illustration see Exhibits 4.2, 4.3, 4.6.

4.75 **The "caring" organization.** The values, attitudes and policies of the organization are based on an overall sense of caring: for its own people; for its clients; for the organization as a whole and for the organization's owners. These values are based on the belief that, in the long run, high organizational performance is a product of people who care rather than of systems that control. For illustration see Exhibits 4.3, 4.5.

4.76 **The "successful" organization.** The organization tries to ensure "success experiences". It sets easily attainable goals at first. In time, the goals are set higher, but always within reach. Initial success creates an appetite for further success, and eventually failure becomes inconceivable: success has been made part of the culture. Typically, people in these organizations are not blind to the risk of failure. However, they are not preoccupied with it and are confident that they can tackle virtually any challenge. For illustration see Exhibits 4.3, 4.7, 4.8.

Participative Leadership

4.77 Leadership in the well-performing organizations is not authoritarian or coercive, but participative. The leaders envision an ideal organization, define purpose and goals, then articulate these and foster commitment in their people. They see the organization as always becoming more and more like the ideal. The well-performing organizations communicate easily internally and with others. Staff feel comfortable consulting their peers as well as those above and below them. Although formal levels exist for administrative purposes, there are no boundaries that inhibit collaboration in achieving organizational goals.

4.78 **The organization with participative leadership.** Instead of directing through authoritarianism or coercion, this participative leadership guides by being creative, by detecting patterns, by articulating purpose and mission, and by fostering commitment to the goals of the organization. For illustration see Exhibits 4.2, 4.6, 4.8.

4.79 **The "becoming" organization.** Here, the leaders envision an "ideal type" of what the organization could and should be. Once this ideal is defined, they continually strive to reach it. They see the organization as always "becoming" more and more like the ideal. For illustration see Exhibits 4.6, 4.8.

4.80 **The communicating organization.** One of the prime functions of the leaders in this type of organization is seen as communicating, rather than as commanding. The leaders inspire and foster communication: they hear, they notice, they encourage, they articulate policy and purpose, they counsel and they reward. Staff at all levels feel comfortable consulting their peers as well as others above and below them. Although formal levels exist for administrative purposes, there are no boundaries that inhibit consultation and collaboration in achieving organizational goals. For illustration see Exhibits 4.3, 4.4, 4.6.

Innovative Work Styles

4.81 Staff in the well-performing organization reflect on their performance, on the environment and on opportunities. They learn from experience. They are innovative, flexible and creative. They maintain strong monitoring, feedback and control systems, but only as useful tools. In effect, the well-performing organization seeks to be self-reliant and to control itself rather than relying on control from outside.

4.82 **The learning organization.** Staff are involved in continual scrutiny of the organization, of its environment, and of its performance in relation to the ideal. They seek to learn from the effects of their actions. They use evaluations, standards and assessments, but always for a productive and defined purpose, never simply because of convention. For illustration see Exhibits 4.2, 4.8.

4.83 **The problem-solving organization.** The organization thrives on identifying opportunities and solving problems. It is innovative and flexible, and it seeks to solve problems creatively. For illustration see Exhibits 4.1, 4.3.

4.84 **The intelligent organization.** Members of the organization review, consult and collaborate with each other as a matter of course. They understand the organization's purpose and mission. They know what needs to be done and what needs to be measured. They build monitoring, feedback and control systems that are useful tools. The organization controls itself rather than depending on control from an outside authority. For illustration see Exhibits 4.3, 4.4, 4.6, 4.7.

Strong Client Orientation

4.85 People in these organizations focus strongly on the needs and preferences of their clients. They derive satisfaction from serving the client rather than the bureaucracy.

There is an alignment of values and purpose between the well-performing organizations and their political and central agency masters with a view to strong performance and high achievement.

4.86 **The organization that is supported by its owners.** Goals are congruent between political, central agency and departmental levels, all of which actively support and reinforce the overall mission. There is an alignment of values, of purpose and of resources toward high organizational achievement and performance. For illustration see Exhibit 4.7.

4.87 **The organization with strong client orientation.** Instead of focussing on a hierarchy and on the authority that rules the hierarchy, people in the well-performing organizations focus on client needs and preferences. People in the organization derive their satisfaction from serving the client, rather than from serving the bureaucracy. Interaction is strong within the organization, but it is perhaps even stronger between the organization and its clients. For illustration see Exhibits 4.1, 4.6.

4.88 **The "concretizing" organization.** Organization members are able to talk in concrete terms about intangible things such as mission and values. They are also able to talk about abstract results in such a way that these become visible and easily discussable. For example, achieving zero mortgage defaults over a long period of time would normally be reflected only in routine paperwork. The well-performing organization finds ways to make such achievements visible by recognizing them through, for example, plaques and awards. As a result, people can better identify with achievement and are motivated to extend their reach. For illustration see Exhibit 4.8.

The Process by which the Organizations Acquired these Attributes

4.89 Our aim in this study was to discover why some organizations perform well and then to report our findings, so that others might profit from them. In the early stages of this study, we believed that documenting the common attributes would be sufficient to serve as a guide for other organizations. However, further reflection and discussion suggested that a specific set of attributes is not necessarily ideal for all situations. Different organizations, and even the same organization at different times, may need different attributes for good performance. Exhibit 4.4, for example, illustrates that the RCMP's Property Management Branch performs well using many standard procedures. In contrast, Exhibit 4.5 shows that the work of IDRC is much less suited to strict regulation.

4.90 Accordingly, we tried to go beyond the attributes and search for the underlying process that allowed the well-performing organizations to develop and maintain their optimum set of attributes. We reasoned that such a process would be both more generic and more informative than simply a list of the attributes themselves. If we could point to such a process, people in other organizations might use it for developing a suitable set of attributes for themselves and thereby improve their performance.

4.91 Perhaps the most significant finding from this phase of the study was that people need to have a certain mindset to initiate such a process. This mindset seems to be a function of strongly held beliefs, of values such as dedication and the innate need to improve the organization in which they work. It became apparent during our discussions that people were not conscious of having used a specific pattern or prescription for success. What they recognized was their need to improve the performance of their organizations.

4.92 One of the deputy ministers told us about posing a challenge to his various branches, after he was appointed, to improve on what they were doing. The response in most cases was that they would try to do better, but that additional resources would be required. One branch, which participated in this study, provided an exception to that general response. Its leaders consulted with their people and found new and better ways, with the same resources, to provide products and services to their clients.

4.93 In another case, a newly-arrived Deputy Minister visited all his branch heads individually and asked them what problems they were having and what help he might be able to provide. The branch heads outlined their various problems, with one exception. That branch, again one in this study, assured the Deputy Minister that they did not have any problems; they were doing just fine. Across the country, wherever the Deputy Minister visited regions and asked representatives of this branch about their problems and difficulties, he received the same answer. Initially, he was skeptical and assumed that the branch head had instructed his people not to tell the DM about any problems. However, as it turned out, it was part of the branch culture to genuinely feel that no problems existed that they couldn't solve on their own.

4.94 In some cases, we found that the process of developing positive attributes was prompted by a crisis or a threat, by a strong demand from an outside influential group, or by an obvious opportunity. Such an opportunity was sometimes created by a newly arriving leader who posed strong challenges while creating an environment of trust and participation.

4.95 The process, once initiated, tends to drive itself. People at various levels discuss, explore, reflect and scrutinize themselves and their activities. They bring together ideas which sometimes result in disagreements. However, because of the mutual trust and respect among people at different levels, these ideas and difficulties become starting points for innovations that result in new ways of working and of achieving. This process gradually becomes ingrained in the culture of the organization, and, ultimately, people tend not to be conscious that this is something special or remarkable.

4.96 For example, it was not until after three in-depth conversations that one Assistant Deputy Minister was persuaded his branch was doing something worth highlighting. He was not conscious that they were doing anything special that wouldn't also be done in similar branches elsewhere in the public service.

Conclusions

4.97 When we began this study, several people were surprised that there should be well-performing organizations in the public service. One of our interviewees, however, put it another way: "Good performance is expected. It shouldn't be a surprise, then, that there is good performance in these organizations. The interesting part is that good performance has been successfully suppressed in most others."

4.98 We realize that we have not been able to find definite answers for all questions that arose during this study. Finding these would require a much more extensive examination than was possible with the resources we had available. One unfinished task, for example, is a detailed study of the underlying process of developing attributes of success, which we have described only briefly. Another question that requires further investigation is whether there is a difference in approach between *changing* the performance of an organization from average to excellent and the challenge of *maintaining* it at that level. We are not at all certain, for example, that the same forces that cause a turnaround are also instrumental in maintaining a high level of performance. A third question yet to be answered is what prompts some managers to initiate a process of reform and improvement. Why would they behave differently from other bureaucrats? Are leaders born like that? Can they be developed? Can such a mindset or such a set of values be acquired from textbooks or courses, or are these values developed by observation and imitation of role models?

4.99 These questions deserve further discussion and further investigation. When we first presented the outline of this study to some of the senior people in the public service, we benefited from insightful advice. Some of the advice dealt with the question of how far to go with this study. Should we attempt to make it comprehensive and complete within our one-year time frame? Should we publish the findings as definitive results and develop authoritative recommendations? The advice said otherwise. Do what you can, it was suggested to us, and publish the best answers you can find. But do not imply that they are final answers. Publish the chapter with the aim of generating thoughtful and wide-ranging discussion at all levels of the public service.

4.100 We have followed that advice. We present this chapter not as a definitive answer to some of the most difficult questions of public service management, but as a starting point for reflection and discussion. The challenge will be to answer more completely the question we posed at the beginning of this study: why do some organizations perform significantly better than others, and what can be done to encourage and assist others to do likewise?

INFORMATION FOR PARLIAMENT
AUDIT OF THE ESTIMATES DOCUMENTS

INFORMATION FOR PARLIAMENT
AUDIT OF THE ESTIMATES DOCUMENTS

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5

INFORMATION FOR PARLIAMENT
AUDIT OF THE ESTIMATES DOCUMENTS

Main Points

In 1981 the Government committed itself to providing Parliament, and hence the public, with improved and expanded information in the Estimates documents. These were to establish an "information base for assessing future intentions in the light of past performance and for holding the government accountable for its performance." Good progress has been made except in reporting program performance and results.

The Estimates documents are in three parts. Part III, expenditure plans for each department and agency, provides details of spending intentions and program performance. We found that these Part III documents are the best single source of information about most departmental programs. They have been improving steadily, and compare favourably with the best we found in other countries. (paragraph 5.31)

Nevertheless, they are not yet a fully satisfactory basis for accountability because they cannot be easily understood by Members of Parliament and the public, and are not complete. Although they contain much valuable and relevant information, it is too hard to extract. When extracted, the information usually presents a valid picture of the program's intentions. (5.41 to 5.112)

In our opinion, three main additions would improve the understandability and accessibility of information in the Part IIIs:

- a short overview of major program components at the start of each program section, which would explain spending intentions and program performance in ordinary language;
- an index; and
- a citation of documentary sources, with these documents being made readily available to Members of Parliament. (5.35)

The Part IIIs can come significantly closer, in terms of completeness, to meeting the Government's commitment on disclosure only through improved reporting of program performance and results. But this will depend on most departments developing improved measurement and reporting systems for program performance. (5.50 to 5.56)

INFORMATION FOR PARLIAMENT
AUDIT OF THE ESTIMATES DOCUMENTS

Introduction

5.1 Each year, Parliament receives three sets of documents containing information that is important to its control of the public purse. The first set, tabled in early February, comprises the Budget Papers, which relate government revenues and expenditure plans to the economy. The second set consists of the Estimates documents, tabled in late February, which provide information on planned expenditures. Finally, in October, the Public Accounts are tabled; they report actual expenditures.

5.2 In this chapter, we report on our examination of the Estimates documents, which form the basis of Parliament's granting of annual Supply to the Government. The power to grant or not grant Supply is the historical basis of Parliament's control of kings and governments. Indeed, since medieval times Parliament has insisted with varying success that it alone had the right to grant the funds needed. The practice of voting Supply annually, based on detailed estimates prepared by the executive, began in the period following 1689, the year William and Mary ascended the British throne. This practice was adopted by Canada in 1867.

5.3 By law, no expenditures may be made by the Government without the express authority of Parliament, and the voting of Supply is one way of granting that authority. One major step in Parliament's Supply procedure is the review of the Estimates documents. While only about 35 percent of the Government's annual expenditures are subject to Supply procedures each year, the Estimates documents always describe all expenditure plans, enabling Parliament to gain an overview of the total. The Estimates documents should, therefore, contain accurate information sufficient to enable Parliament to carry out important aspects of its role of overseeing government operations. Over time, the amount and nature of the information provided by ministers when requesting Supply has of course changed.

5.4 Until recently, Parliament granted Supply based on the amounts requested for salaries, together with forecasts of the cost of such items as telephones, office stationery, and other supplies and equipment. The 1961-62 Estimates for the Technical and Vocational Training Assistance Program of the Department of Labour, reproduced in their entirety in Exhibit 5.1, show clearly the particular items money is to be spent on. However, as illustrated in this example, ministers did not explain in the Estimates documents the purpose of the proposed expenditures or what had been accomplished with previous expenditures. In 1968, the Estimates documents were revised so that ministers provided more information on the purposes of expenditures, in a program planning and budgeting format. In 1981, the Estimates documents were revised again, calling for ministers to provide information on program performance and accomplishment.

5.5 In the 1981 revision, the Government committed itself to providing both to Parliament and the public at large an entirely new type of information. Previously, Estimates

Exhibit 5.1

AN EXTRACT FROM THE 1961-62 ESTIMATES

ESTIMATES, 1961-62
DETAILS OF SERVICES

Number		Details		Amount	
1961-62	1960-61			1961-62	1960-61
		LABOUR - *Continued*		$	$
		TECHNICAL AND VOCATIONAL TRAINING ASSISTANCE			
		Administration			
1	1	Director, Vocational Training Branch, Labour ($11,000-$12,500)		12,500	10,050
3	3	Technical Officer 10 ($8,820-$10,500)		29,505	25,650
1	1	Technical Officer 9 ($8,120-$9,800)		8,300	7,500
1	1	Administrative Officer 2 ($6,000-$6,660)		6,660	6,180
2	2	Clerk 4 ($4,050-$4,500)		8,775	7,665
1	1	Clerk 2 ($2,970-$3,420)		3,420	3,150
1	1	Stenographer 3 (Secretary) ($3,570-$4,020)		3,540	3,150
1	1	Stenographer 2 ($3,090-$3,540)		3,540	3,150
1	1	Typist 2 ($2,820-$3,180)		2,940	1,860
		Estimated net requirement for Increases in Rates of Pay (allotted from General Salaries Vote)			254
12	12	Full time Positions (Detailed above)	(1)	79,180	68,609
		Professional and Special Services	(4)	13,000	8,800
		Travelling Expenses	(5)	10,000	8,000
		Freight, Express and Cartage	(6)	200	200
		Telephones and Telegrams	(8)	350	350
		Publication of Reports and Bulletins on Vocational and Apprenticeship training	(9)	8,525	6,600
		Films and Other Promotional Publicity	(10)	9,000	8,500
		Office Stationery, Supplies and Equipment	(11)	750	1,000
		Expenses of National Technical and Vocational Training Advisory Council	(22)	8,500	6,500
		Expenses of Conferences on Apprenticeship and Vocational Training	(22)	7,400	4,600
		Expenses connected with Commonwealth Technical Training Week	(22)	10,000	30,000
				146,905	143,159
			Expenditure		
		Fiscal Year, 1959-60	$ 94,453		
		Fiscal Year, 1960-61:			
		Actual to November 1, 1960	$ 52,224		
		Estimated for balance of year	90,935		
		Estimated total for 1960-61	$ 143,159		
		Payments to the Provinces			
		Assistance to Trade and Vocational Schools, Technical Institutes, and Technical and Vocational High Schools:			
		Capital Assistance		14,775,000	
		Assistance towards operational costs of Trade and Vocational Schools and Technical Institutes		3,125,000	
		Assistance towards operational costs of Technical and Vocational High Schools		1,965,000	
		Vocational and Technical Schools Assistance			5,525,900
		Assistance for Training Programs:			
		Training of Unemployed Workers		4,000,000	1,310,000
		Apprenticeship Training		2,263,000	1,990,000
		Training of Foremen and Supervisors		25,000	17,500
		Training in Primary Industries		157,100	157,100
		Training for Technical and Vocational Teachers, Supervisors and Administrators including financial assistance to persons participating in such training		75,000	
		Training of Disabled Persons		370,000	306,500
		Assistance to Students attending post high school courses of Science and Technology below University level		100,000	
		Assistance to Other Students		219,600	219,600
		Vocational Correspondence Cources		4,000	5,000
		Training of Service Tradesmen		30,000	26,000
				27,108,700	9,557,600
		Less - Anticipated Lapses		508,700	360,000
			(20)	26,600,000	9,197,600
			Expenditure		
		Fiscal Year, 1959-60	$ 8,152,692		
		Fiscal Year, 1960-61:			
		Actual to November 1, 1960	$ 1,285,337		
		Estimated for balance of year	7,912,263		
		Estimated total for 1960-61	9,197,600		

information was solely about spending intentions. The revised Estimates were to be dual-purpose documents containing information on both planned expenditures and actual performance. They would enable planned and actual departmental performance to be reviewed by the same standing committee; and they would establish the desired information base both for assessing future intentions in light of past performance and for holding the government accountable for its performance.

5.6 The Estimates documents consist of three parts: Part I is the overall government expenditure plan; Part II, also called the Main Estimates, contains the amounts requested for each department and the wordings of the Appropriation Acts; and the Part IIIs, in 78 volumes in 1988-89, contain detailed information on activities and expenditures planned by individual departments. In addition, the Supplementary Estimates are tabled at least twice a year to obtain Parliament's approval for changes in spending authorities for the fiscal year.

5.7 In the next section, we record the Government's commitment to disclosure in the Estimates documents. This is followed by short sections that state the audit scope, describe our approach and present our general conclusions. The main body of the chapter is devoted to describing the problems we found and to making recommendations and suggestions for improvement.

Government Commitment to Disclosure

5.8 The 1983 Guide to the Estimates sets out the Government's commitment to Parliament for disclosure of information in the Part I:

> The Expenditure plan [Part I] establishes the basis of the government's accountability to Parliament for the level of government spending, and for the distribution of such spending among policy areas (envelopes). In support of this purpose, Part I of the Estimates elaborates on the multi-year expenditure plan by providing an overview of government spending. This overview includes highlights of spending patterns from year to year and shows the relationship between government spending and the economy. As well, Part I contains an extensive description of the plans for each of the ten policy areas, including the government's policy objectives and initiatives. Major spending implications of such initiatives over the five-year planning period are also discussed. Such information allows Parliament both to review the policy initiatives of the government as part of its consideration of the Estimates, and to hold the government accountable for performance.

5.9 Since 1983, the government expenditure management system has evolved in two significant ways. First, two central agencies responsible for helping ministers co-ordinate policies on economic development and social development were abolished. The responsibility for drafting the overview called for by the Guide was thus dispersed. Second, the Government adopted the practice of a fixed date for the Budget immediately preceding the tabling of the Estimates. Consequently, some information that was to be revealed in Part I of the Estimates documents is now being reported in the Budget Papers, particularly in the Fiscal Plan.

5.10 The government policy on disclosure in the Part IIIs is stated by the Treasury Board in Circular 1982-8: to improve "the government's accountability to Parliament by providing more and better information on government programs, thereby permitting parliamentarians to carry out more effectively their reviews of expenditures." To that end, the policy states that Part IIIs shall "provide sufficient information to assist Members of Parliament in understanding and assessing planned and actual program performance, in terms of results and related resources."

5.11 Specific guidelines have been issued by the Office of the Comptroller General on behalf of the Treasury Board to assist ministers in preparing the Part IIIs for their departments. The guidelines elaborate six principles of disclosure, namely relevance, reliability, objectivity, completeness, materiality and comparability.

5.12 In our opinion these principles, when applied with good judgment, provide a valid description of a program and its context. Consequently they were implicit in the audit criteria for our examination of the Estimates documents, where we assessed whether the description presented was a valid representation of the program, its context and its results. We added two general criteria which are based on the needs of Members as expressed to our audit team. These general criteria are also implicit in the government disclosure policy and apply equally to the Part I and the Part IIIs. They are understandability and accessibility, which are defined as follows:

- A reasonably informed person who lacks detailed knowledge of government operations and the program described should be able to understand the program by reading the Part III.
- Information on particular topics should be easy to find in the Part III, and the Part III should clearly explain how and where more detailed information on these topics may be obtained.

Conflicting Interests

5.13 Providing complete and meaningful information on a program may cause embarrassment for a department. Therefore, the temptation is to consign some unfavourable facts or trends to the shadows of obscurity. In the United Kingdom, a recent study of information for Parliament made two points: "For ministers, the priority is that the figures are defensible, not understandable, and obscurity may even have its advantages"; and, "Since one of Parliament's main functions is to exercise a scrutiny over government expenditure, there is no glossing over the fact that the interest of Parliament and the government will not be the same."

5.14 The existence of this conflict of interest was acknowledged more than a century ago when Parliament authorized the creation of the Office of the Auditor General. The Auditor General was given the power to report the occurrence of certain events which otherwise might not become publicly known.

5.15 The Government's obligation to reveal is more political than legal. According to Beauchesne, the rules of the House of Commons are that a minister may "decline to answer a question without stating the reason for his refusal, and insistence on an answer is out of order, with no debate being allowed. A refusal to answer cannot be raised as a question of privilege, nor is it regular to comment upon such a refusal. A Member may put a question but has no right upon an answer." Nevertheless, the importance of good information to democracy was stated by a former Canadian Prime Minister:

> Democratic progress requires the ready availability of true and complete information. In this way people can objectively evaluate the government's policies. To act otherwise is to give way to despotic secrecy.

5.16 In keeping with the traditions of a democratic society, the Canadian Government has demonstrated its good intentions with respect to disclosure by revising the Estimates documents in the late 1960s and again in the early 1980s, and by continuing its efforts to improve them.

Audit Scope

5.17 We examined all three parts of the Estimates documents as well as the Supplementary Estimates for adherence to the Government's commitment on disclosure.

5.18 We assessed Part I for its understandability and the completeness of its information. For Part II, we determined whether its numerical and other formal information was consistent with that in the Part I and the Part IIIs.

5.19 The bulk of our audit work was done on the Part IIIs of eight departments. In these departments, the selected programs were all undergoing comprehensive audits. We examined the Part IIIs for the fiscal years 1987-88 and 1988-89, mainly to determine whether they described these programs validly and understandably.

5.20 In effect, this chapter is a status report on the revision of the Estimates started in 1981.

Audit Approach

5.21 At the start of our audit, we looked at the flow of information on governmental activity that reaches Parliament. Besides the major reports presented regularly by the government, the flow included Question Period, Questions on the Order Paper, responses to Members' queries by staff of the Library of Parliament, the use of media reports by Members, and contributions by academics and spokespersons for various interest groups.

5.22 We were thus able to gain an understanding of the place and contribution of the Estimates documents in the overall system, and the role of the Estimates information in enabling Parliament to exercise its oversight of the government. The Estimates documents are a minor, yet vital, proportion of the total volume of information flow.

5.23 Our second task involved interviewing 31 Members of Parliament and others we thought might use the information provided in the Estimates. These others included researchers for the caucuses, committees, and the Library of Parliament, as well as journalists, academics and other analysts. Our purpose was to determine their information usage and needs, as well as their assessment of the Estimates documents, and to solicit their suggestions for improvement.

5.24 We also interviewed a number of public servants in several departments who are responsible for preparing their departments' Part IIIs. This was to give us an understanding of the preparation process and to obtain their views for improving the process and the documents.

5.25 In 1987, the Office reported on financial management and control in nine departments, with observations and conclusions concerning the Part IIIs of these departments. We observed that information to Parliament had improved with the revision of the Estimates but that major weaknesses persisted. For instance, the descriptions of how resources were to be used to produce results were often deficient. Measures of efficiency and cost information rarely existed. We built on these findings in developing the conclusions for this chapter.

5.26 We reviewed documents comparable to our Estimates from other countries, namely the United Kingdom, France, Mexico and New Zealand. The most pertinent are those of the United Kingdom, and we have included some examples from the U.K. documents.

General Conclusions

5.27 On examining the Estimates documents, we came to separate conclusions on the information provided in each part, as follows.

Part I: Government Expenditure Plan

5.28 Part I currently provides clear and precise links between the Fiscal Plan of the Budget and the Government's expenditure plans revealed in detail in the Estimates documents. Our analysis shows that it does not provide an extensive description of government plans, policy objectives and initiatives. Part of this descriptive material can be found in the Fiscal Plan of the Budget papers. However, even the two documents together do not describe well the implications and context of major spending initiatives over the five-year planning period.

5.29 The evolution of the expenditure management system noted earlier is a root cause of the incompleteness of the Part I in relation to the Government's 1983 commitment on disclosure. There is a need for the Government to review how best to fulfil its disclosure commitment to Parliament in light of the changes to its procedures for expenditure management.

Part II: The Main Estimates

5.30 Our audit of Part II of the Estimates, which contains the detailed wordings and amounts of the authorities that Parliament will be asked to approve in the appropriation bill, revealed no inconsistencies with related information in Part I or the Part IIIs.

Part IIIs: Departmental Expenditure Plans

5.31 The Part IIIs are designed to provide information to Members of Parliament on departmental spending intentions and about performance and results produced with expenditures previously authorized. They provide a great deal of useful information. In spite of some deficiencies, our opinion is that the Part IIIs are the best single source of information about most departmental programs. They have been improving steadily since they were introduced in the early 1980s, and they compare favourably with the best we found in other countries.

5.32 Nevertheless, the Part IIIs are not yet a fully satisfactory basis for accountability because they cannot be easily understood by Members of Parliament and the public. Although they contain much valuable and relevant information, it is too hard to extract.

5.33 In some cases, the standard structure of the documents hinders communication. In others, the content is at fault: sometimes significant information is omitted or is incorrect; sometimes too much detail hides any messages. In some Part IIIs, improved reporting of program performance and results is required. But correcting this will depend on most departments developing improved measurement and reporting systems.

5.34 In still other cases, understanding is made unnecessarily difficult because of the typeface, layout, writing style or other factors in the presentation.

5.35 In our opinion, the Part IIIs can be improved with respect to understandability and accessibility of information with three main additions:

- a short overview of major program components at the start of each program section, which would explain spending intentions and program performance in ordinary language;
- an index; and
- citation of documentary sources, with these documents made readily available to Members of Parliament.

Other changes and additions, discussed later on, can also lead to improved communication.

Supplementary Estimates

5.36 The Treasury Board has indicated that it plans to introduce an improvement in the format of the Supplementary Estimates. Specifically, an updated list of spending authorities for all votes is to be published along with each Supplementary Estimate. Nevertheless, in general these documents still provide little in the way of explanation or justification for the increased authorities being requested. In many cases the increased spending authority is of an essentially administrative nature – a department needs an authority increase in one vote to allow it to make necessary expenditures using unexpended money authorized in another vote. In other cases, expenditures are to be made for unforeseen events. In the latter, better explanations and justifications should be provided.

Observations and Recommendations

5.37 The recommendations and suggestions that follow are intended to make the Estimates documents more useful to Members of Parliament. Their adoption would bring the information actually provided closer to the high standard called for by the Government's policy on disclosure in the Estimates.

5.38 Suggestions are based on observed weaknesses in the Part IIIs as well as on examples from departmental documents and from United Kingdom Supply documents. The fact that we have based some suggestions on the U.K. Supply-related documents should not be interpreted as implying that we believe those documents cannot be improved. In fact, both they and the process of Supply itself are currently under review. Nevertheless, our Estimates documents could benefit from adopting a few of the U.K. practices as well as some from other Canadian documents.

5.39 Our observations and recommendations for improvement are presented in four groups under the headings understandability, accessibility, content and communication, which embrace the disclosure principles listed earlier. Although separated here, the issues raised in the four groups are very much interrelated.

Improving Understandability

5.40 When the Government committed itself to revising the Estimates, officials of the Office of the Comptroller General surveyed Members of Parliament to find out what information they needed. The main need the Members expressed was for highlights and summaries of departmental programs. They also requested that mandates, objectives and organization for program delivery be explained, and planning perspectives and measures of program effects be reported. In response, the Office of the Comptroller General prepared guidelines that established structure and content standards for the information. Although Members accepted the guidelines as appropriate at the time, they now report the Part IIIs to be unsatisfactory in certain respects.

5.41 We found there were three primary reasons underlying the difficulties Members had with the Part IIIs:

- the structure causes the information on program components to be widely dispersed;
- overviews of major program components are not provided; and
- the content requirements, particularly with respect to reporting program performance and results, are often not met.

5.42 **Structure.** The adopted structure frequently fragments the information on any one program component so that it is hard to find and understand. Part of the difficulty lies in the approach to describing government programs. Money is voted for a program that may be composed of several components formally called activities, sub-activities, perhaps sub-sub-activities and even planning elements. These various lower-level components may be quite large, and often they are of greater interest to Members of Parliament and the public than the higher level programs. Notwithstanding this, the Part IIIs are designed to describe the higher level programs.

5.43 For an example of what occurs now, consider the Employment and Insurance Program of Employment and Immigration Canada. This program has four activities, one of which is the National Employment Services; this in turn has three sub-activities, one being called Labour Exchange. Information relevant to the $112 million Labour Exchange component is scattered over several locations in a section 82 pages long dedicated to describing the $4.2 billion Employment and Insurance Program. Some idea of the dispersion of this material is given in Exhibit 5.2, which is a collage of some of the information on the Labour Exchange. On the other hand, the collage also shows that a large amount of information is provided, a big increase since 1962, as exemplified in Exhibit 5.1.

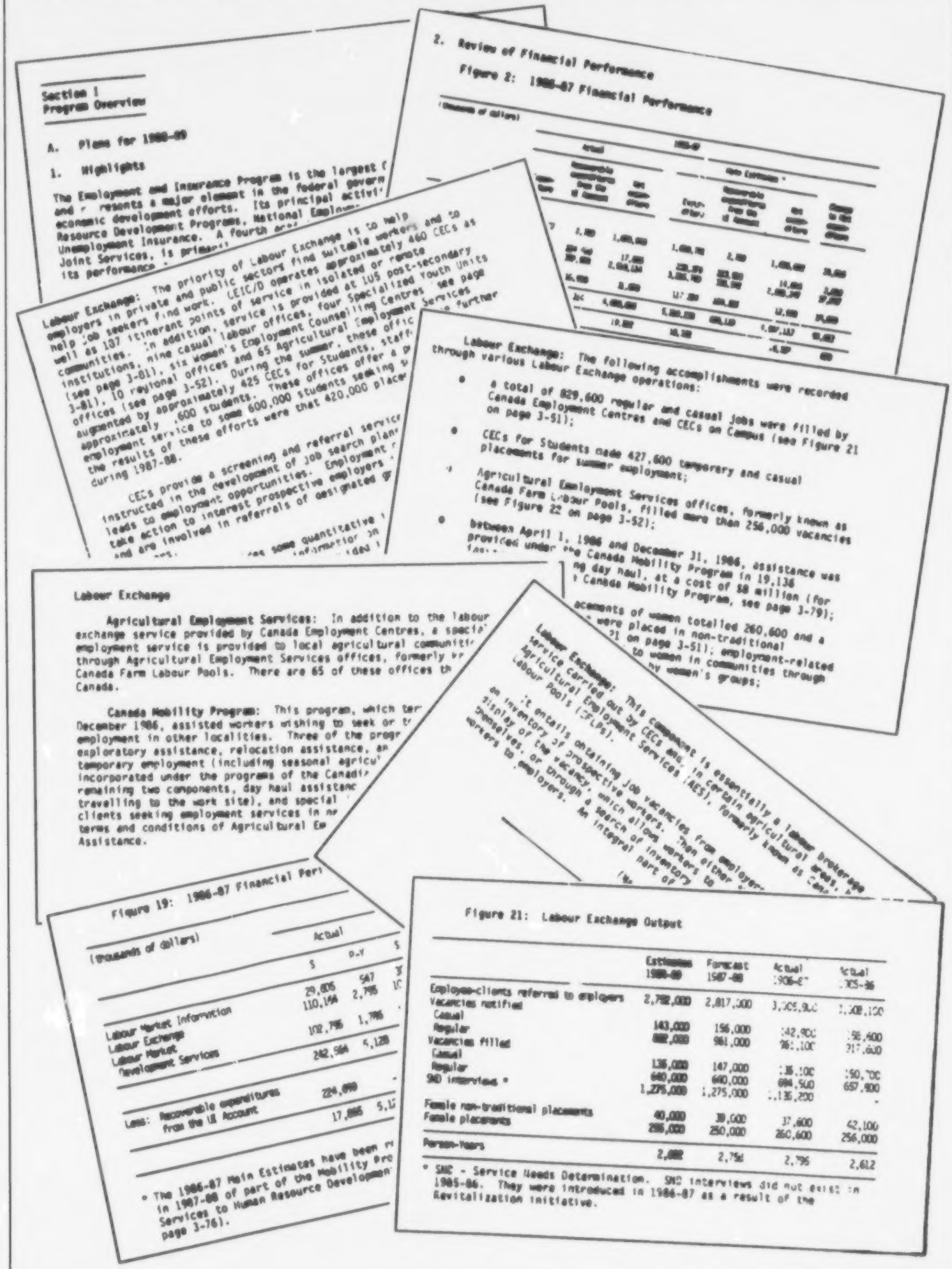
5.44 Another example of dispersed information is provided by the Canadian Forestry Service, which delivers more than half of its program funds according to federal-provincial agreements. References to expenditures on federal-provincial development agreements amounting to $139 million appear on 12 different pages of the Service's Part III. The financial information on these agreements is on 18 different pages.

5.45 **Overview.** It would be much easier for Members to get a quick overview of program components if the U.K. approach were followed. The U.K. Public Expenditure White Paper presents descriptions of significant program components as integral units but without much detail. An example of the overview of a business development and job creation program is given in Exhibit 5.3. The basic descriptive information is reported in one place: aim, what is done, who the clientele are, indication of the results, and costs.

5.46 In the Part IIIs even a financial overview is sometimes hard to find. Consider the CEIC Labour Exchange example. The simple question, "What is the source of funding?" is difficult to answer. For an indication of the difficulty, see Exhibit 5.4. It is worth repeating here that the complexity apparent in this example is a reflection that the adopted structure of the Part IIIs is not perfectly suited to each and every government program structure.

Exhibit 5.2

EXTRACTS FROM THE EMPLOYMENT AND IMMIGRATION CANADA PART III SHOWING THE DISPERSION OF INFORMATION ON THE LABOUR EXCHANGE SUB-ACTIVITY



Section I
Program Overview

A. Plans for 1988-89

1. Highlights

The Employment and Insurance Program is the largest
and r resents a major element in the federal govern
economic development efforts. Its principal activi
Resource Development Programs, National Employm
Unemployment Insurance. A fourth
Joint Services, is prima
its performance

2. Review of Financial Performance

Figure 2: 1986-87 Financial Performance

Labour Exchange: The priority of Labour Exchange is to help
employers in private and public sectors find suitable workers and to
help job seekers find work. CEIC/D operates approximately 460 CECs as
well as 137 itinerant points of service in isolated or remote
communities. In addition, service is provided at 105 post-secondary
institutions, nine casual labour offices, four Specialized Youth Units
(see page 3-81), six Women's Employment Counselling Centres (see page
3-81), 10 regional offices and 65 Agricultural Employment Services
offices (see page 3-52). During the summer, these offic
augmented by approximately 425 CECs for Students, staff
approximately ,600 students. These offices offer a p
employment service to some 600,000 students seeking s
the results of these efforts were that 420,000 placer
during 1987-88.

CECs provide a screening and referral servic
instructed in the development of job search plan
leads to employment opportunities. Employment
take action to interest prospective employers
and are involved in referrals of designated g

Labour Exchange: The following accomplishments were recorded
through various Labour Exchange operations:

- a total of 829,600 regular and casual jobs were filled by Canada Employment Centres and CECs on Campus (see Figure 21 on page 3-51);
- CECs for Students made 427,600 temporary and casual placements for summer employment;
- Agricultural Employment Services offices, formerly known as Canada Farm Labour Pools, filled more than 256,000 vacancies (see Figure 22 on page 3-52);
- between April 1, 1986 and December 31, 1986, assistance was provided under the Canada Mobility Program in 19,136
ng day haul, at a cost of $8 million (for
Canada Mobility Program, see page 3-79);
acements of women totalled 260,600 and a
were placed in non-traditional
21 on page 3-51); employment-related
to women in communities through
by women's groups;

Labour Exchange

Agricultural Employment Services: In addition to the labour
exchange service provided by Canada Employment Centres, a specia
employment service is provided to local agricultural communiti
through Agricultural Employment Services offices, formerly kn
Canada Farm Labour Pools. There are 65 of these offices th
Canada.

Canada Mobility Program: This program, which ter
December 1986, assisted workers wishing to seek or t
employment in other localities. Three of the progr
exploratory assistance, relocation assistance, an
temporary employment (including seasonal agricu
incorporated under the programs of the Canadi
remaining two components, day haul assistanc
travelling to the work site), and special
clients seeking employment services in ne
terms and conditions of Agricultural Em
Assistance.

Labour Exchange: This component is essentially a labour brokerage
service carried out by CECs and, in certain agricultural areas, b
Agricultural Employment Services (AES), formerly known as Can
Labour Pools (CFLPs).

It entails obtaining job vacancies from employer
an inventory of prospective workers. Then either
display of the vacancy, which allows workers to
themselves, or through a search of inventory
workers to employers. An integral part of

Figure 19: 1986-87 Financial Per

(thousands of dollars)	Actual $	Actual P-Y
Labour Market Information	29,806	547
Labour Exchange	110,154	2,795
Labour Market Development Services	102,795	1,786
	242,564	5,128
	224,699	
Less: Recoverable expenditures from the UI Account	17,865	

- The 1986-87 Main Estimates have been re
in 1987-88 of part of the Mobility Pro
Services to Human Resource Developmen
page 3-76).

Figure 21: Labour Exchange Output

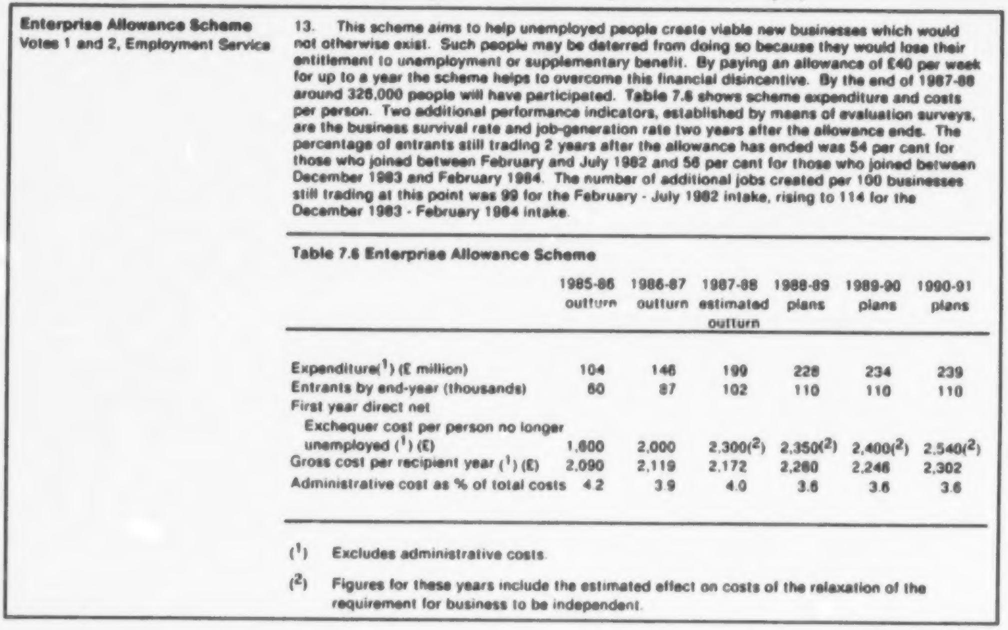
	Estimates 1988-89	Forecast 1987-88	Actual 1986-87	Actual 1985-86
Employee-clients referred to employers	2,792,000	2,817,000	3,005,900	3,308,100
Vacancies notified				
Casual	143,000	156,000	142,900	158,400
Regular	882,000	961,000	961,100	717,600
Vacancies filled				
Casual	136,000	147,000	135,100	150,700
Regular	640,000	640,000	694,500	657,900
SND interviews *	1,275,000	1,275,000	1,136,200	-
Female non-traditional placements	40,000	39,000	37,600	42,100
Female placements	286,000	250,000	260,600	256,000
Person-Years	[illegible]	2,758	2,796	2,612

* SND - Service Needs Determination. SND interviews did not exist in 1985-86. They were introduced in 1986-87 as a result of the Revitalization initiative.

Exhibit 5.3

A CONCISE OVERVIEW OF A PROGRAM COMPONENT

(Taken from the United Kingdom 1988 Public Expenditure White Paper)



Enterprise Allowance Scheme
Votes 1 and 2, Employment Service

13. This scheme aims to help unemployed people create viable new businesses which would not otherwise exist. Such people may be deterred from doing so because they would lose their entitlement to unemployment or supplementary benefit. By paying an allowance of £40 per week for up to a year the scheme helps to overcome this financial disincentive. By the end of 1987-88 around 326,000 people will have participated. Table 7.6 shows scheme expenditure and costs per person. Two additional performance indicators, established by means of evaluation surveys, are the business survival rate and job-generation rate two years after the allowance ends. The percentage of entrants still trading 2 years after the allowance has ended was 54 per cent for those who joined between February and July 1982 and 56 per cent for those who joined between December 1983 and February 1984. The number of additional jobs created per 100 businesses still trading at this point was 99 for the February - July 1982 intake, rising to 114 for the December 1983 - February 1984 intake.

Table 7.6 Enterprise Allowance Scheme

	1985-86 outturn	1986-87 outturn	1987-88 estimated outturn	1988-89 plans	1989-90 plans	1990-91 plans
Expenditure(1) (£ million)	104	146	199	228	234	239
Entrants by end-year (thousands)	60	87	102	110	110	110
First year direct net Exchequer cost per person no longer unemployed (1) (£)	1,600	2,000	2,300(2)	2,350(2)	2,400(2)	2,540(2)
Gross cost per recipient year (1) (£)	2,090	2,119	2,172	2,260	2,246	2,302
Administrative cost as % of total costs	4.2	3.9	4.0	3.6	3.6	3.6

(1) Excludes administrative costs.

(2) Figures for these years include the estimated effect on costs of the relaxation of the requirement for business to be independent.

5.47 Those Members of Parliament we interviewed in the spring of 1988 preferred the U.K. approach – at least, as far as obtaining an overview was concerned. They did not want, however, to lose the important details that are currently published in the Canadian Part IIIs.

5.48 One way to compromise between the two requirements – overviews and adequate details – would be to keep the current content standards but also start each program section of a Part III with a succinct overview of program components as in the U.K. document.

5.49 We acknowledge that the depiction of complex governmental programs in a simple and succinct way is very difficult. Any structure adopted for presenting information will have deficiencies from some point of view. Nevertheless, we believe that the structure we suggest would be superior insofar as developing an overall understanding of a department's programs is concerned.

5.50 **Reporting program performance and results.** The Government has committed itself to reporting the performance of programs, including their results and effects, in the Part IIIs. Last year, in the chapter on Financial Management and Control, we reported that managers seldom have the information they need to know whether their operations are economic, efficient and effective. Consequently, few departments can routinely provide the information on performance required to satisfy the Government's commitment to Parliament.

Exhibit 5.4

THE SOURCE OF FUNDING FOR THE LABOUR EXCHANGE

The page references are to the 1988-89 Employment and Immigration Canada Part III.

On page 3-12 the title "Labour Exchange" first appears. On page 3-18 the diagram of the activity structure reveals that the Labour Exchange is a sub-activity of the National Employment Services. The Labour Exchange is thus a component of the National Employment Services activity of the Employment and Insurance Program of CEIC.

page 3-5 The table "Program by Activities" shows the National Employment Services will be allocated a total of $250.576 million. Of this, $233.663 million is from "revenues credited to the vote" and $16.913 million is to be obtained out of the $4.279 billion noted on page 3-4 in the table "Financial Requirements by Authority."

Where does the $233.663 million come from?

page 3-10 The table "Financial Requirements by Activity" reveals that there are "Recoverable expenditures from the UI Account."

page 1-6 A footnote to the "Spending Plan by Program" states the method of calculating the UI costs is presented starting on page 5-13.

page 5-14 Figure 5 shows the costs of the "UI Portion" of the National Employment Services to be $233.7 million. This amount is to be transferred from the Unemployment Insurance Account.

Volume I, page 7.6 of the 1986-87 Public Accounts of Canada reveals that the Unemployment Insurance Account received about $9.6 billion from outside sources and $2.8 billion as the government's share of the premiums in calender year 1986. This payment is made pursuant to the UI Act.

It can be seen that the source of funding for the Labour Exchange is three-fold:

- **the UI revenues collected from employers and employees;**
- **the subsidy paid to the UI Account by the government according to the UI Act; and**
- **a portion of the money to be voted at Supply for the Employment and Insurance Program.**

5.51 This situation continues, and little performance information is provided for many of the programs we looked at. For instance, Post-Secondary Education Assistance in the Indian and Inuit Affairs Program, which encourages registered Indians and Inuit to acquire post-secondary education, costs about $100 million a year. While statistics are available on participation rates, the Part III does not give any comparative or program performance data that would help the reader assess the results of the program. The Department does not systematically collect information on graduation rates, total number of graduates, number of graduates by field of study, employment figures or other relevant data. Thus, the Department cannot fulfil the commitment made by the Government to Parliament.

5.52 We recognize that it is particularly difficult to develop high-level indicators of performance for complex programs. In fact, for some programs overall indicators are impossible to develop, but for others they are possible despite the complexity of an operation.

5.53 An example of a difficult measurement problem is found in the Department of National Defence. In 1984, this Department started the development of a system for measuring and reporting defence capability for internal purposes. Indicators of program performance in a military context can be expressed in such terms as sustainability, operational readiness and combat capability. Sustainability measures how long military formations can be sustained, or supplied from existing inventories, while in battle. Operational readiness measures how long it will take to get military forces to the field of battle. Combat capability describes the ability of formations and equipment to meet the perceived threat. The Department has agreed to develop appropriate indicators, in consultation with the Office of the Comptroller General, which would be reportable to Parliament in the Part IIIs of the Estimates, while preserving the obligation to ensure that publishing them does not compromise national security.

5.54 Good performance indicators for a simple program are given in Exhibit 5.3, the U.K. job creation program presented earlier as an example of a concise overview. The number of persons participating (entrants) is reported along with the costs per person no longer unemployed.

5.55 At present, the required structure of a Part III calls for indicators of effectiveness and results to be reported in a special subsection of what is usually a long overview section. One consequence is that program results are not physically close to their associated costs or purposes, making comprehension difficult. As an example of a different approach, in Exhibit 5.3, the business survival rate and the job generation rate two years after incentive subsidies end are printed close to statements of purpose and cost.

5.56 Including indications of performance and effectiveness in an overview is desirable for several reasons. First, the description of a program is easier to understand because, for example, the objectives, purposes and costs are clearly related to specific and concrete results. Second, personal accountability for having such indicators is more clearly attributable to the responsible program manager. Third, parliamentary oversight of programs operating without appropriate performance indicators is simplified because such programs are easily identified.

5.57 The Office of the Comptroller General should modify the guidelines governing the preparation of the Part IIIs of the Estimates to call for:

- **a brief descriptive overview of major program components at the start of each program section; and**
- **inclusion in the overview of selected indicators of effectiveness and performance as well as information on costs and purposes of each program component.**

5.58 Departments should intensify their efforts to measure and report the performance and results of programs and their components.

Improving Accessibility

5.59 Parliament has traditionally had the right, which it regularly exercises, to examine government activities from any perspective at any level of detail. Supplying all information that any Member might conceivably require would, of course, be impractical. Nevertheless, further details and explanations should be readily available to supplement the information in the Part IIIs. The supplementary information and that contained in the Part IIIs should be easy to find.

5.60 **Index.** The word "program" is used in several different ways, and this presents a problem. The Cabinet and ministers talk about programs. Appropriation is in terms of programs. Policy is related to programs. Budgeting is by program. Public servants work on programs. Performance evaluation is by program. The public receives the services of programs. Accountability is centred on programs. And the Part IIIs are designed to describe the highest level of program – as noted in the section on structure – associated with an Appropriation Act.

5.61 On the other hand, Members of Parliament and the public often want to know about a particular component of a program that is delivering a service to the public. Unfortunately, there is no index in the Estimates documents by program component. To find the information they seek, Members and the public may have to search through a whole set of Estimates.

5.62 Consider the Salmonid Enhancement Program of the Department of Fisheries and Oceans. This program costs about $42 million a year and is potentially very important to the West Coast economy. However, an interested reader must search through the whole of the Department's Part III to find its costs, purposes and effects. References to the program appear on at least nine non-sequential pages of the 1988-89 Part III. And its effects are not reported there, but in the 1987-88 edition.

5.63 Indexing the Estimates would particularly aid Members when they want to put forward constituent, special or regional interests to ministers and the public service. This job can require information from the expenditure plans of several departments. For example, a Member may be interested in the impact of downsizing on particular laboratories, say, the Bedford Institute of Fisheries and Oceans, the Algonquin Radio Observatory of the National Research Council and the Agriculture Research Station in Saskatoon. Without a geographic or institution index, Members and their researchers cannot find the needed information easily. In an actual case, one experienced caucus researcher told us he had spent two hours trying to obtain certain information about an airport. He said he had to skim most of the Department of Transport's Part III – 219 pages – to find the information. It was reported in the section on Airport Revolving Funds, as called for by the guidelines. But such searches are frustrating.

5.64 Further, since Members use the Estimates mostly for reference, an index by program component, by institution and by geographic location would make the documents more useful for this purpose.

5.65 When the revised Estimates were introduced, a Guide to the Estimates was distributed along with the other volumes. An annual edition of the Guide would be a logical place to publish a general index.

5.66 Departments should develop indexes for their Part IIIs.

5.67 The Office of the Comptroller General should develop an index for the whole collection of the Estimates documents.

5.68 Reference documents. The more detailed and complete the Part IIIs become, the larger and more difficult they are to use. One way to resolve this dilemma would be to increase the use of references to other documents. Another would be to improve the ability of departments to provide information on demand. A third would be to increase the skill of Members and their researchers in using the available information sources.

5.69 Following are examples of how a list of references could improve accessibility to detailed information in two departments.

5.70 Through the Canadian International Development Agency (CIDA), Canada provides aid to about 100 countries each year. In the CIDA Part III, no list of the countries receiving aid or the amounts paid to each is provided, although there is such a list in the CIDA annual report. However, the list would take up about seven pages of small print, and the same argument could be presented for other pieces of detail. If all such material were included, the Part IIIs would become so large as to be unmanageable. To resolve this dilemma, the CIDA Part III could identify the documents containing relevant information, and the Agency then ensure that Members and their researchers can quickly obtain copies of documents they need.

5.71 In another example, Indian Affairs delivers its programs to various bands and organizations. Members may be interested in knowing the amounts of money received by each band or organization. This information is given in the Public Accounts and could be cited, as its inclusion would increase the size of the Part III by several pages.

5.72 In the United Kingdom, the use of bibliographies is the established practice for their Supply documents. Further, when a minister introduces a bill into the House, it is routine to give the Clerk of the House 100 copies of the relevant documentation for prompt distribution on demand. If a similar practice were to be adopted in Canada, Members of Parliament would have quick access to background documents on the Government's position.

5.73 Several Members and researchers told us they occasionally had difficulty obtaining public documents from departments. Giving public documents like program evaluation reports to the Library of Parliament would solve many problems of access.

5.74 Departments should include a list of references to relevant public documents in their Part IIIs and should ensure that these documents are readily available to Members of Parliament.

Improving Content

5.75 If departments complied with the guidelines, they would provide appropriate and sufficient information in their Part IIIs. However, it is easier to write standards than to comply with them. Whether to include or exclude each piece of information requires judgment, and this is the key difficulty, whereas accuracy and reliability of the information included are relatively easy to address. In the following paragraphs we present suggestions and recommendations on how the content can be improved. The suggestions made by Members and other users are boxed for easy reference.

5.76 **Reliability.** Inconsistencies in data presented in a report can cause problems out of all proportion to their relative importance. If readers notice an inconsistency, they may tend to question the reliability of the whole report. Or they may think they have not properly understood the presentation, and have to go back over it again. Obviously, it is a waste of time to backtrack in this fashion when the problem is in the text and not a lack of understanding on the part of the reader.

5.77 In this year's CIDA Part III, we found examples of poorly edited data. For instance, on page 16 it is stated that bilateral programs consume 43 percent of the budget, but on page 37, one can calculate the number as 45 percent using up-to-date information. The difference amounts to about $40 million. In addition, the English version of Figure 9 indicates internal transfers to be an increase of $46.4 million, while the French version indicates a reduction of the same amount.

5.78 In the Department of Agriculture Part III, inaccuracies of a different nature resulted in ambiguity and possible misinterpretation. The 1987-88 Part III states that "Agriculture Canada has evaluated the testing requirements which would ensure that residue levels in meat, dairy, fruit and vegetable products are within acceptable levels", and the 1988-89 Part III states that "residue testing will continue to be a high priority for such commodities as meat, dairy, fruit and vegetables". We believe such statements imply that there is an extensive testing program. However, our comprehensive audit of that Department, reported in Chapter 8, found that the residue testing procedures are not sufficient to provide reasonable assurance that residues in food and agricultural products are detected. Further, it was found that only limited residue testing had been done on fruit and vegetables in 1987-88, or before.

5.79 **Relevance and completeness.** Consider the Part III of the Public Debt Program, Department of Finance. Although it complies in form with the guidelines, in our view the explanation of the program is inadequate. From the information provided it is simply not possible to understand what the program is doing. One Member characterized the section as being "a triumph of non-information." In our opinion, the description does not fulfil the Government commitment for disclosure in the Part III. For an example of what should be in the Public Debt Program Part III, see Exhibit 5.5. Some of the omitted information is published in the Budget Papers and could be cited in the Part III.

Exhibit 5.5

WHAT SHOULD BE DISCLOSED IN THE PUBLIC DEBT PROGRAM PART III

The description of the Public Debt Program should convey the importance of the Public Debt Program, what is done, how it is done, who does it, and what its full costs are.

The program is responsible for borrowing to finance the government's cash requirements not covered by revenues. The amounts borrowed are hundreds of billions of dollars each year, most of which is used to refinance "old" debt as it matures. It is the largest expenditure program of government and its spending is pre-emptive–that is, interest on the debt must be paid as a first charge on the Consolidated Revenue Fund. As projected, interest charges will make up an increasingly large proportion of government spending.

Program managers know how much "old" debt must be refinanced and they are provided with information on the government's "new" cash requirements. Other units within Finance and the Bank of Canada also provide views on interest rates and market conditions. However, the Public Debt program managers must finally recommend how much is to be borrowed at any one time and under what terms and conditions. As well, they must also decide how best to invest "surplus" cash balances over the days that separate borrowing action.

The Bank of Canada is the fiscal agent and "banker" for the government, handling much of the issuing and administration work. The annual servicing and issuing costs, excluding many services provided by the Bank of Canada without charge, vary greatly from year to year. For 1988-89, the estimate is given as $238 million in the Part III. The estimate for 1987-88 is $304 million. The actual in 1986-87 was $272 million. There is no explanation of this fluctuation.

Mention should be made of the gross amount of the public debt on which interest is being paid; historical context should be given for the accumulated debt or annual interest payments.

The current gross public debt is over $300 billion and has been growing at a compound rate of over 10 percent in each of the past five years. The interest rate paid averaged about 8.8 percent in 1987. The trends over past decades could be shown using data published in the Budget papers for gross debt as a percentage of GNP/GDP or of interest payments on the gross national debt.

The Part III could indicate how the borrowing program affects other public programs and the broader Canadian economy .

The program dominates the bond market, representing about 60 percent of the total. The decisions of the managers can have an impact on monetary policy as well as on other borrowers and investors.

Describe important program activities and give their costs.

5.80 Sometimes important program activities or functions are not described. For example, the Department of Fisheries and Oceans has a function called Resource Allocation which establishes the regulations for fish catch quotas, fishing seasons, equipment characteristics, etc. The importance of this function is not clearly indicated, its methods are not described, and it is not costed.

5.81 In another example, the Indian and Inuit Affairs program is changing its approach to funding programs for Indian communities. The new scheme is called Alternative Funding Arrangements (AFA), and it replaces some of the contributions programs of the past. Under the AFA, bands will be able to design their own programs with more financial flexibility than before. The Department anticipates that, during 1988-89, 30 AFA agreements will be in place to provide funding of $100 million for 75 bands. This significant level of funding is not disclosed in any of the tables that present AFA and transfer payment information.

5.82 There is a description in the Revenue Canada - Taxation Part III that is incomplete because of significant omissions. Accounts receivable, as reported in the Part III, are made up of 1.28 million accounts owing $3.3 billion in 1986-87. No mention is made, however, of additional receivables arising from the Scientific Research Tax Credit (SRTC) program amounting to $2.7 billion which, according to departmental records, were outstanding at 31 March 1987.

5.83 In addition, there is no mention of "write-offs" of accounts receivable, which have increased year by year from about $50 million in 1982-83 to about $600 million in 1986-87. Since this trend is not reported, obviously explanations for it are not given. Further, the contribution of the SRTC to the whole is not revealed.

5.84 CIDA also could improve the information content of its Part III. Over the past few years, CIDA has been changing its program delivery mechanisms in two ways. During the period when the 1988-89 Part III was being written, the Agency decided to decentralize its program delivery. The decision is not revealed in the Part III largely because it was not made public until after publication of the Part III. On the other hand, for several years CIDA has increasingly used contractors rather than public servants to deliver its aid projects. This trend to contracting is not clearly revealed in the Estimates, although it is implicit in parts of the document.

Provide more comparative information to help Members understand the context, performance and justification for the activity.

5.85 Members told us they wanted more comparative information to enable them to understand and assess programs and initiatives. The Part IIIs we examined provided little comparative information or, if they did, the presentations needed upgrading. While the guidelines call for "comparability" of data year by year, many Part IIIs do not do this as well as they might.

5.86 In the National Defence Part III, for example, a table shows the defence costs of Canada in comparison with those of other NATO countries. The U.K. Statement on the Defence Estimates conveys the same message more clearly in a graph (Exhibit 5.6). Similar international comparisons would be valuable as background for issues such as health care spending, public debt, foreign trade and agricultural subsidies.

5.87 As another example, the narrative of the Fisheries and Oceans Part III fails to provide certain important contextual information. For instance, it does not describe the extent of the economic and social problems related to overcapacity of the fishing fleet and processing plants. The numbers of fishermen or families dependent on the fisheries are not given; nor, more importantly, are the long-term trends and demographic projections of their numbers. Providing more of this kind of information would be an important improvement in the Department's Part III.

Link the Part III to the Supplementary Estimates where appropriate.

5.88 When the Estimates documents were revised, a reporting convention was adopted that the Part IIIs would be based on the previous year's Main Estimates; they would not be adjusted for intervening Supplementary Estimates. Supplementary Estimates are usually about four or six percent of the total, and this convention normally causes no problem. However, sometimes Supplementary Estimates for a department are proportionately much larger and the use of this convention can be misleading.

5.89 In the Department of Agriculture, for example, the Special Canadian Grains Program has been financed in part by Supplementary Estimates for the past three fiscal years to the amount of $2.1 billion. On page 2-9 of the Agriculture Part III, the estimated 1988-89 departmental expenditures are compared with the forecast expenditures for 1987-88. The comparison is distorted because the forecast includes a large expenditure authorized through the Supplementary Estimates process while the 1988-89 estimate does not. Specifically, the Part III states: "The Department estimates total expenditures in 1988-89 of $2,177,505,000. This represents a decrease of $1,219,781,000 or approximately 35.9% less than forecast expenditures in 1987-88." In reality, the bulk of the decrease is due to the absence of the large Supplementary Estimate of earlier years.

Report longer time trends for expenditure and performance information.

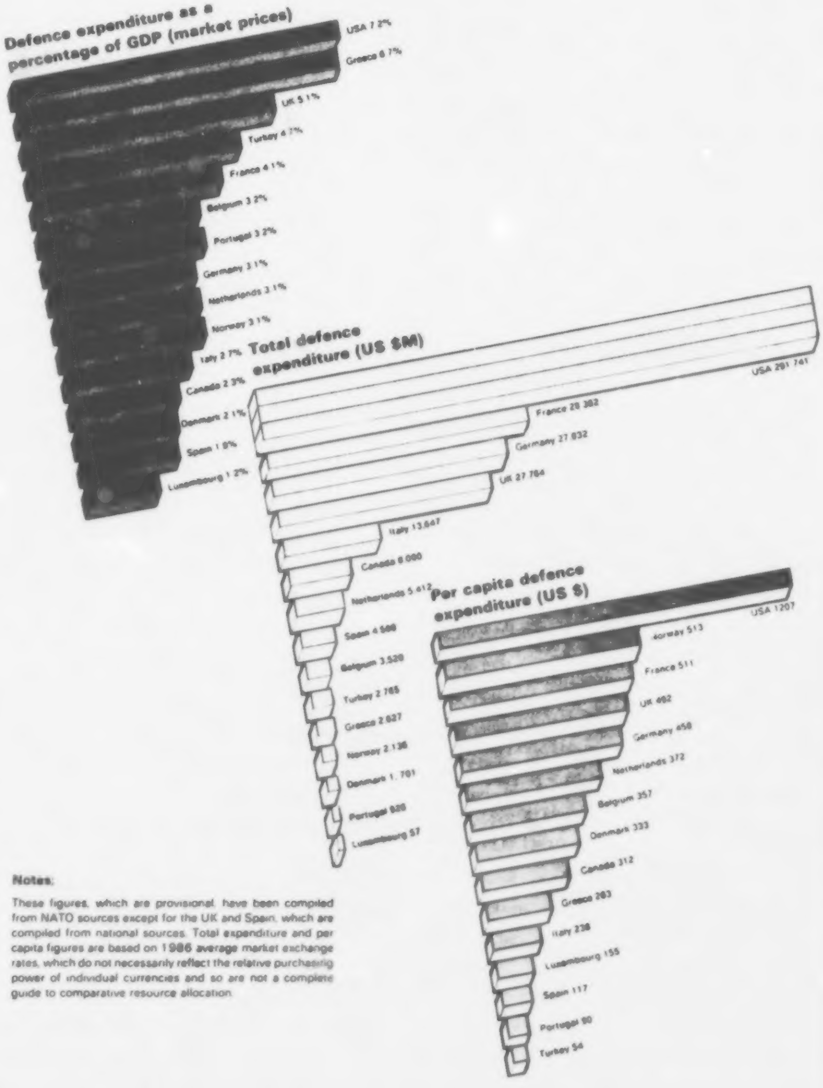
5.90 The guidelines for preparing the Part IIIs call for a five-year time span: three years back and two years ahead. Usually only a three-year time span is provided, with the years labelled "Estimates", "Forecast" and "Actual." The three quantities represent different things that are not easily comparable, and, in the absence of adequate historical context, the result is confusion.

Exhibit 5.6

AN EFFECTIVE USE OF GRAPHICS

(Taken from the United Kingdom 1987 Statement on the Defence Estimates, Volume I)

Figure 11 A Comparison of Defence Expenditure: NATO countries 1986



Notes:

These figures, which are provisional, have been compiled from NATO sources except for the UK and Spain, which are compiled from national sources. Total expenditure and per capita figures are based on 1986 average market exchange rates, which do not necessarily reflect the relative purchasing power of individual currencies and so are not a complete guide to comparative resource allocation.

5.91 In the United Kingdom documents, the Public Expenditure White Paper routinely provides up to six years of historical data as well as three years of forecast. For many programs, unit costs for the same extended periods of time are also routinely reported.

5.92 Some users of the Canadian Estimates documents told us they do not retain back copies, usually because of storage space limitations. Thus, even if they do want to spend time and effort, they cannot easily construct a time series of expenditure or performance.

Provide historical context for programs periodically where appropriate.

5.93 Information on programs that are addressing issues of long standing could usefully be augmented by more graphs showing historical trends. Such a historical view was provided in the Fisheries and Oceans Part III of 1987-88, which contained a graph of the landings of lobsters on the Atlantic Coast since 1890.

5.94 In the United Kingdom equivalent to our Part I, a section providing historical background to selected issues has just been introduced. If this were to be done in the Part I, it would comply more fully with the government policy on disclosure.

Indicate spending in the same areas by other departments.

5.95 Many departments undertake major expenditures on programs that are related to those of other departments. We believe information about the spending of other programs provides important context for departmental programs described in a Part III. Originally, the Part I was to contain this type of information. In last year's annual Report, we recommended that the Department of Agriculture collate and report the major spending initiatives on agriculture by other departments, and we drew up a table to show how it could be done. In the 1988-89 Part III, the Department presented a table (on page 1.6) showing the total appropriations to the Agriculture portfolio and another (on page 6.41) showing the Department of Transport expenditures on certain agriculture programs.

5.96 The Department of Indian Affairs and Northern Development produces a useful annual report about other departments' and governments' spending on northern development. An extract of this report is reproduced as Exhibit 5.7.

5.97 The heart of the government commitment to Parliament was that Members of Parliament, and the public, would be able to understand the context, performance and cost of programs by reading the revised Estimates documents. In many cases, the content of departmental Part IIIs is insufficient to discharge this commitment fully.

5.98 **Each department should establish a review process to ensure that its Part III complies with government policy on disclosure in the Estimates documents.**

Exhibit 5.7

SPENDING ON NORTHERN DEVELOPMENT

A display of planned expenditures on northern development by all departments and governments for 1987-88. This was copied from "Annual Northern Expenditure Plan, 1987-88" published under the authority of the Minister of Indian and Northern Affairs.

Trend in Expenditure ($ millions) and Percentage Distribution (%) by Spending Agency

Agency	1973/74 Actual		1984/85 Actual		1985/86 Actual		1986/87 Forecast		1987/88 Planned	
Federal	$	%	$	%	$	%	$	%	$	%
Defence	20.2	10.3	59.4	8.2	77.1	11.1	137.4	17.8	166.5	20.5
DIAND	67.3	34.1	180.5	24.9	137.9	19.8	154.6	20.0	133.1	16.4
Health & Welfare	23.1	11.7	107.8	14.9	113.4	16.3	118.0	15.3	120.1	14.8
Transport	26.7	13.5	109.7	15.1	93.4	13.4	95.6	12.4	103.4	12.7
CEIC	8.5	4.3	51.2	7.1	55.2	8.0	53.0	6.9	53.0	6.5
Environment	10.2	5.2	41.7	5.8	34.1	4.9	42.8	5.5	44.6	5.5
RCMP	6.8	3.4	36.2	5.0	37.5	5.4	37.7	4.9	39.4	4.9
CMHC	0.5	0.2	22.1	3.1	28.8	4.1	19.9	2.6	33.0	4.1
Fisheries & Oceans	2.7	1.4	24.5	3.4	23.7	3.4	23.4	3.0	21.2	2.6
Post Office	3.3	1.7	18.3	2.5	19.2	2.8	20.3	2.6	21.0	2.6
Public Works	13.0	6.6	28.1	3.9	24.3	3.5	15.7	2.0	20.3	2.5
EMR	6.4	3.3	20.0	2.8	20.0	2.9	21.5	2.8	20.3	2.5
RIE	–	–	6.4	0.9	11.1	1.6	10.5	1.4	14.1	1.7
Sec State	1.9	1.0	9.6	1.3	10.1	1.5	12.0	1.6	9.8	1.2
PSC	–	–	2.5	0.3	2.6	0.4	3.1	0.4	3.7	0.5
Labour	0.2	0.1	1.3	0.2	1.6	0.2	1.9	0.2	2.4	0.3
Justice	0.2	0.1	1.3	0.2	1.4	0.2	1.7	0.2	1.7	0.2
Revenue	0.5	0.2	0.9	0.1	0.9	0.1	1.0	0.1	1.0	0.1
Veterans Affairs	0.3	0.2	0.7	0.1	0.7	0.1	0.8	0.1	0.8	0.1
Fed Judicial Affairs	0.1	0.1	0.5	0.1	0.6	0.1	0.7	0.1	0.7	0.1
Museums	0.2	0.1	0.6	0.1	0.6	0.1	0.6	0.1	0.7	0.1
Communications	0.6	0.3	0.9	0.1	0.6	0.1	0.5	0.1	0.4	0.1
CBC	3.3	1.7	–	–	–	–	–	–	–	–
Finance	1.0	0.5	–	–	–	–	–	–	–	–
Total	197.1	100.0	724.2	100.0	695.0	100.0	772.5	100.0	811.1	100.0
Federal	197.1	55.8	724.2	49.6	695.0	44.4	772.5	42.7	811.1	42.1
NWTG	115.4	32.7	569.4	39.0	669.3	42.8	775.7	42.9	851.3	44.1
YTG	40.7	11.5	166.0	11.4	200.5	12.8	261.9	14.5	266.2	13.8
Total	**353.2**	**100.0**	**1,459.7**	**100.0**	**1,564.9**	**100.0**	**1,810.1**	**100.0**	**1,928.6**	**100.0**

(Editor's note: Observant readers will identify minor discrepancies in the numbers reproduced in this exhibit)

Improving Communication

5.99 For good communication, the sender should first determine what information the receiver needs to know and then consider how to present it most effectively.

5.100 **Communicating to Parliament.** Our interviews with Members indicated that they wanted the Part IIIs to provide information as called for by government policy, but in an understandable way.

5.101 Often the reason the Part IIIs are not effective documents for communicating with Parliament is that those preparing them do not see this as a major purpose of the document. Sometimes discussions with officials showed that the document was viewed primarily as a vehicle to convey information on performance and intentions to the Treasury Board Secretariat. It was a document written by public servants for public servants.

5.102 We often found that departmental people responsible for writing the Part IIIs did not clearly understand what Members wanted or how best to communicate with them. Very often a Part III was prepared by the people in the finance section of a department. From their point of view, cost figures for the planned expenditures were of prime significance, and the narrative describing purpose, objectives, results and so on was of lesser importance. In some cases the people responsible for program delivery had not read the description of their programs in the Part III.

5.103 It is clear that some departments need to modify the procedures for preparing their Part IIIs, perhaps by having program personnel more involved. They might also assign communications staff to edit their documents or at least analyze the presentation.

5.104 Departments should ensure that the writers of the Part IIIs focus on communicating with Members of Parliament in ordinary language.

5.105 Presentation and style. Simple writing style and good presentation are important aids to communication.

5.106 We did an analysis of certain narrative sections in a number of Estimates documents and found the language to be complex and difficult to understand in some cases. Many of the documents contain examples of jargon-laden prose, such as:

> The deterioration of the economic situation in most countries in the Americas led to the establishment of polysectoral lines of credit in support of structural adjustment programs.

5.107 One overview used such words and phrases as micropropagation, silviculture, allowable annual cut and employment-related information base. Such terms are understood by experts and experienced Members of Parliament, but they do create problems for the ordinary reader. It appears that some writers have forgotten that the targeted audience consists of Members of Parliament and, through them, the public, and not experts.

5.108 Departments should simplify the writing style and reduce the use of jargon.

5.109 Diagrams are relatively scarce in the Part IIIs. Many that are presented are poorly labelled, and their purpose is far from clear.

5.110 Both Part I and Part II of the Canadian Estimates use two colours to make clear the distinction between the current Main Estimates and those of the previous year. If adopted in the Part IIIs, this practice would aid understanding.

5.111 The typeface and layout of the U.K. documents are superior to those of the Canadian documents. One may see this by comparing Exhibit 5.2, the Canadian collage, with Exhibit 5.3, the U.K. example. However, in making such comparisons, one must be aware of the greater time for preparation available to producers of the U.K. documents.

5.112 **The Office of the Comptroller General and departments should collaborate in improving the way Part IIIs are presented and make more effective use of colour, graphics, layout and typefaces.**

GROUP SURGICAL MEDICAL INSURANCE PLAN

GROUP SURGICAL MEDICAL INSURANCE PLAN

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6

GROUP SURGICAL MEDICAL INSURANCE PLAN

Main Points

The Group Surgical Medical Insurance Plan (GSMIP) is the largest private health insurance plan of its kind in Canada. It provides medical and hospital coverage for 400,000 employees and pensioners of the federal and territorial governments, certain Crown corporations and other entities. Annual premiums were more than $100 million in 1987. Claims paid were $85 million. Accumulated surpluses and reserves at the end of 1987 were $93 million. (paragraphs 6.2, 6.3)

Treasury Board Secretariat, in consultation with the National Joint Council which must agree with any policy and financial changes, needs to examine how effectively and efficiently GSMIP is being managed. In our opinion, there is a significant need for a thorough review of existing financial arrangements, for closer monitoring of the insurer's activities, and for the use of professional underwriting and actuarial expertise to assist in doing this. (6.14 to 6.67)

This would contribute to better premium rate setting procedures, provide opportunities for significant cost savings and improved cash flow, and help ensure more efficient claims processing. (6.14 to 6.67)

Both Treasury Board Secretariat and the insurer recognize that alternative funding arrangements would result in annual cost savings to the Plan through the reduction of premium and sales taxes. This could be as much as $2.5 million each year. (6.46, 6.47)

GSMIP has been insured by the same life insurance company since the Plan began in 1960. Given the size and importance of the Plan, Treasury Board would be well advised to go out to competitive bidding on a periodic basis – say, every five or ten years. (6.48, 6.49)

GROUP SURGICAL MEDICAL INSURANCE PLAN

Introduction

6.1 Treasury Board Secretariat (TBS) is responsible for the overall administration, including policy management, of the federal government's employee benefit plans. This year, we examined how the Secretariat administers one of the major health insurance plans, the Group Surgical Medical Insurance Plan.

Description of the Plan

6.2 The Plan is a private health insurance plan sponsored by the Government of Canada to provide medical coverage in Canada for federal employees and pensioners, as well as those of territorial governments and of participating Crown corporations and agencies and certain other groups. It also provides comprehensive medical coverage for employees and pensioners residing outside Canada.

6.3 GSMIP is the largest plan of its kind in Canada. Some 400,000 persons are covered under the Plan. Annual premiums, which are cost-shared by Plan members and employers, totalled more than $100 million in 1987. Treasury Board's share of the premiums, as employer, was $38 million. Claim payments to Plan members during the same period amounted to $85 million. Accumulated surpluses and reserves at the end of 1987 were $93 million.

6.4 The principal underwriter of the Plan is a Canadian life insurance company (the insurer). The insurer is also responsible for administering the payment of claims. At the request of the Government when the Plan began in 1960, the insurer established a separate claims office in Ottawa to handle only GSMIP claims.

Audit Scope

6.5 Our audit objective was to review the systems and procedures that Treasury Board Secretariat has in place for ensuring that it administers GSMIP efficiently, economically and effectively. As part of our audit, we examined the financial and administrative arrangements with the insurer. In this regard, we looked at the process for setting premium rates, determining expense charges and calculating reserves, and compared them with industry practice and experience. We also reviewed procedures at the GSMIP claims office and audited a selected number of claims. To assist us in our audit, we engaged benefit plan consultants with experience in insurance underwriting and claims operations.

6.6 The unhesitating cooperation of the insurer throughout the audit was appreciated.

Administration of the Plan by Treasury Board Secretariat

6.7 The Benefits Group Insurance Section in the Personnel Policy Branch of Treasury Board Secretariat is responsible for the overall administration of employee insurance plans and programs, including GSMIP. The Section is responsible for dealing with the Department of Supply and Services and with the insurer. It reviews Plan financial performance on a regular basis and keeps abreast of changes in federal and provincial programs and in the health insurance industry. It is responsible for policy formulation and co-ordination and consultation with the insurer and unions on these matters. It also handles enquiries from Plan members, provinces and unions.

6.8 Before policy changes are approved by Treasury Board, there is an extensive series of discussions and consultations that must take place. The most significant of these is with the National Joint Council (the Council), which is made up of representatives from management and bargaining agents.

6.9 Changes in premium rates and benefits are reviewed and agreed with the Council. The financial operations of the Plan are reviewed and discussed annually with the Council, and a comprehensive policy review of the Plan is undertaken every three years. The last review took place in 1987.

6.10 The Section also acts as Secretariat to the Advisory Committee on the Group Surgical Medical Insurance Plan. This Committee reviews claims disputes and makes recommendations to resolve them.

6.11 We found that TBS staff in the Insurance Section, who on average have 15 years' experience in this area, are knowledgeable about health plan operations. They have a good working relationship with the insurer and with other government departments. In the Section, there are four benefits officers, one of whom is primarily responsible for GSMIP and several other plans.

6.12 Some private sector employers have on staff people with insurance underwriting or actuarial experience or, alternatively, use outside experts on a regular basis. The Office of the Superintendent of Financial Institutions normally reviews the annual financial report for GSMIP (its last review was in 1986 for the 1985 operations). The Office is also represented on the National Joint Council Health Committee which reviews premium rate changes. However, it does not carry out detailed actuarial reviews in this area and other areas of plan operations. TBS also engages outside consultants from time to time to review the operations of its insurance plans but has never done so for GSMIP.

6.13 TBS places considerable reliance on the advice and guidance provided by the insurer. It also depends on the insurer to provide an efficient and accurate claims processing operation.

6.14 Our audit showed a significant need for a thorough review of existing financial arrangements, for closer monitoring of the insurer's activities, and for the use of professional underwriting and actuarial expertise on a regular basis to assist in doing this.

Financial Arrangements with the Insurer

Background

6.15 GSMIP is a fully insured, experience-rated plan. Under current financial arrangements, premiums are paid to the insurer to cover expected claims, Plan expenditures such as administration costs, and reserves. Any surpluses or deficits which arise are held by the insurer and the re-insurers on behalf of the Plan. Interest on these amounts is credited or charged to the Plan.

Current Financial Arrangements

6.16 We believe several important changes could be made within the existing insured agreement that could result in cost savings and improved cash flow for the Plan.

6.17 **Setting premium rates.** Based on the insurer's recommendations for changes to premium rates, which are reviewed by the National Joint Council, Treasury Board sets premium levels for the Plan. The insurer and the Secretariat then monitor claims experience to determine if premiums are sufficient to cover the claims. If there are deficiencies, the insurer has the right to request rate changes.

6.18 Most employers set premium rates on an annual basis. In the case of GSMIP, the recent practice has been to set rates that will remain unchanged for two or three years in order to maintain premium rate stability. Also, it allows for the extensive time needed to obtain approval for rate changes (for instance, consultation with the National Joint Council on proposed changes may take several months) and to reprogram revised payroll deductions.

6.19 Also, premium rates are established in such a way that each line of insurance coverage is self-supporting. This is to ensure that premiums paid by members under one line are not used to subsidize other members under another line.

6.20 The current premium levels were established in September 1985. Our review of Plan experience for the years 1985, 1986 and 1987 showed that total premium levels were higher than necessary. For instance:

- In the Supplementary (Extended Health Care Benefit) portion of the Plan, which accounts for two-thirds of GSMIP premiums, the premium rates were increased by an average of 75 percent in September 1985. However, claims paid subsequent to that date have been less than expected.
- Level 1 and 2 optional hospital benefits were producing surpluses in 1984 and 1985, and continued to do so despite some benefit increases. At the end of

1985, the accumulated surplus for Level 1 hospital benefits was $18 million. At the end of 1986, this had grown to $22 million. In July 1987, as a result of the triennial review by the National Joint Council, $20 million of this surplus was transferred to the Supplementary Plan to finance new vision and hearing benefits, which it was estimated would result in additional annual claims of $9 million. By the end of 1987, another $3 million of surplus had been generated. Similarly, accumulated surpluses for Level 2 hospital benefits had grown from $4.3 million at the end of 1985 to $9.9 million in 1986 to $16.3 million in 1987. Although some benefit improvements are planned, it does not appear that they will result in significant reduction of these surpluses over the short term.

6.21 Having higher than necessary premium rates results not only in large surpluses being generated but in higher expenditures which could be deferred to future years. This is because certain charges to the Plan (such as profit charges and premium taxes) are based on a percentage of premiums paid.

6.22 The premium rates established in 1985 appear to have been far too conservative. Using information contained in the GSMIP 1984 annual financial report, and assumptions and factors that were known at that time, our consultants calculated what they considered to be a reasonable rate increase for the Supplementary portion of the Plan. In retrospect, a rate increase of 55 percent, instead of the 75 percent increase, would have been sufficient.

6.23 There are several reasons for this difference. The insurer's rate was based on the assumption that the high increases in claims costs of the late 1970s and early 1980s (over 20 percent) would continue; this did not happen. Also, the insurer had originally prepared its premium rate recommendations in July 1984. These were updated in January 1985 but the rate change was not approved until August 1985. There is no mechanism in place that provides for the review and update of assumptions immediately prior to approval.

6.24 For a plan of this size and complexity, and given that rates are being set on a two- to three-year basis, we believe the Secretariat would be well advised to consider obtaining independent actuarial or underwriting advice when changes in premium rates to the Plan are being made, to critically review the reasonableness of the insurer's recommendations.

6.25 Notwithstanding the advantages of rate stability and the complexities and length of time needed to introduce rate changes, we believe there is a need for the Secretariat to explore ways to implement rate changes on a more frequent basis. The use of step rates, which have been used occasionally, would be one alternative. At a minimum, a mechanism is needed to ensure that proposed rate changes are based on up-to-date assumptions.

6.26 **Treasury Board Secretariat should improve the process for setting premium rates by:**

- **exploring the feasibility of engaging outside expertise to help in reviewing the adequacy and reasonableness of recommended premium levels;**

- **ensuring that assumptions supporting proposed rate changes are kept up-to-date;**
- **assessing whether there are ways of setting premium levels on a more frequent basis than every two or three years.**

6.27 **Retention of reserves and surpluses.** Under fully insured plans such as GSMIP, insurance carriers require the provision of reserves to pay for outstanding liabilities when the plan is terminated. These reserves, which are funded from premiums paid, generally increase each year in proportion to the growth in claims and expenses. At 31 December 1987, they amounted to $28 million.

6.28 For the past five years, total premiums received have exceeded claims and expenditures. This has resulted in significant accumulated surpluses. At 31 December 1984, 1985, 1986 and 1987, they were $21 million, $30 million, $45 million and $65 million respectively. (See Exhibit 6.1.)

6.29 Under the current arrangements for GSMIP, the insurers retain the use of Plan reserves and any surpluses. The insurer pays the Plan interest on these amounts, which in 1987 averaged 7.8 percent.

6.30 In view of the increasing size of the reserves and the significant amount of surplus funds on hand, we believe that the Secretariat should examine different options for investing these funds. For instance, one option would be the establishment of a trust account to hold and invest the funds for the benefit of the Plan. If they were invested in higher-yield but still low-risk securities, we estimate that the Plan could earn additional annual interest income of $900,000 (based on the 1987 balances and assuming a one percent spread between short and long term interest rates).

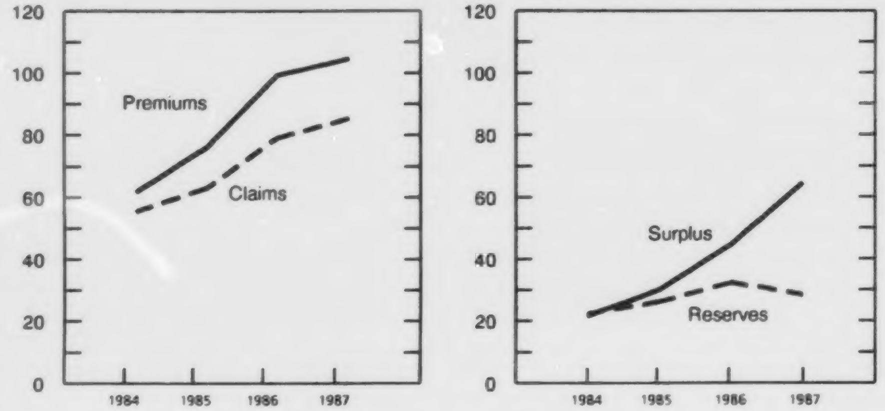
6.31 Treasury Board Secretariat should actively explore alternative ways of holding reserves and surpluses, with a view to maximizing interest income for the Plan.

6.32 **Alternative banking arrangements.** At present, the insurer is responsible for all GSMIP banking arrangements. We believe it would be worthwhile for TBS to investigate whether alternative arrangements would improve cash flow opportunities for the Plan.

6.33 One possibility would be the establishment of a bank account into which all premiums would be deposited and from which the insurer would draw cheques daily to cover claims payments of the prior day. The expenses of the insurer would be drawn daily or monthly. The bank account could be administered either by the employer on behalf of the members or by the insurer. The advantage of this type of arrangement is that the insurer would receive funds only as needed, and all investment income on excess funds would accrue to the Plan.

Exhibit 6.1

GROUP SURGICAL MEDICAL INSURANCE PLAN
Activity and Balances in the Plan for Past Four Years
(in millions of dollars)



Premiums and claims paid during the year **Accumulated surplus and reserves at December 31**

Source: GSMIP Anniversary Reports - 1985-1987

6.34 This arrangement also would permit the Plan to earn interest on the cash float (claims cheques that have been issued but not cashed). We estimate that for GSMIP this would result in additional annual savings of $ 160,000.

6.35 **Treasury Board Secretariat should investigate the feasibility of adopting alternative banking arrangements that would improve cash flow opportunities for GSMIP.**

6.36 **Profit charges.** The insurers' profit charge is based on a percentage of premiums. Currently, it is one-half percent of premiums paid. The total charge in 1987 was $521,000. As premiums escalate, so will the profit charge.

6.37 Given the significant size of the Plan, it might be possible for TBS to negotiate a profit charge based on a flat dollar amount rather than a percentage formula.

6.38 **Treasury Board Secretariat should enter into discussions with the insurer about alternative ways of determining profit charges.**

6.39 **Re-insurance charges.** Normally, insurers enter into re-insurance arrangements when there is a large element of risk involved. This is not the reason in the case of GSMIP, which is a government-sponsored plan.

6.40 When the Plan was established, the federal government decided that the business was to be shared among a number of Canadian insurance carriers. To do this, a re-insurance arrangement was entered into between the insurer and 17 other insurance carriers, whereby the insurer holds 20.5 percent of the liability and the balance is held by the others. Similar arrangements exist for the federal government's other insured health plans.

6.41 The effect of this arrangement has been to increase the costs of the Plan. Annual re-insurance charges now exceed $200,000. Given that these costs are significant and that the Government has since established additional employee insurance plans with carriers other than the insurer, this arrangement may no longer be appropriate.

6.42 **Treasury Board Secretariat should review the necessity for continuing with the present re-insurance arrangements.**

6.43 **Negotiating and documenting financial arrangements.** Some large employers have agreements with their insurers to cover important aspects of the financial arrangements, such as the formula for calculating reserves, the methods for determining expense charges and interest credits and charges, and provisions for the withdrawal of surpluses and reserves. No such agreements are in place for GSMIP.

6.44 Given the significant size of the Plan, there is a need for important financial arrangements to be reviewed and discussed on a regular basis with the insurer, and for the results of the review and decisions taken to be documented.

6.45 **Treasury Board Secretariat should enter into a formal agreement with the insurer that would detail all financial arrangements of the Plan negotiated by the Government and the insurer.**

Alternative Funding Arrangements

6.46 Over the years, TBS and the insurer have discussed changing the financial underwriting arrangement for GSMIP to the more cost-effective self-insured or partially insured arrangements used by some large employers for their medical plans.

6.47 Self-insured or partially insured underwriting arrangements would reduce or eliminate premium taxes and Quebec sales taxes. Depending on the nature of the funding, this would result in annual savings to the Plan of between $2.2 million and $2.5 million.

6.48 Exhibit 6.2 illustrates the potential annual savings that could be achieved through adopting alternative financial arrangements. The GSMIP is the largest health plan of its kind in Canada. The financial arrangements have remained virtually unchanged since the inception of the Plan in 1960, and options to amend these arrangements have been reviewed only informally. Moreover, we noted that there are no procedures for going out to competitive bidding on a periodic basis - say, every five to ten years.

6.49 **Treasury Board Secretariat should carry out a formal assessment of existing financial arrangements for GSMIP to determine whether they are the most appropriate and cost effective. It should also consider periodically inviting competitive bids.**

Claims Processing and Administration

6.50 The GSMIP claims office in Ottawa, established by the insurer at the request of the Government, not only provides claims payment services, but also acts as an information source for Plan members and their dependents.

6.51 **Monitoring of claims operations by TBS.** Treasury Board Secretariat does not have procedures to monitor the efficiency of the Plan's claims operations. Instead, it has relied on the insurer to provide an appropriate level of service. Nor does the Secretariat have any written agreement with the insurer that outlines its expectation of the level of service to be provided.

6.52 Given the significant size of the Plan, and our findings, such procedures would appear essential. Without active monitoring procedures, Treasury Board Secretariat cannot adequately assess the efficiency of the GSMIP claims processing operations.

6.53 Our review found good systems and procedures in many aspects of the GSMIP claims processing operations. There are good procedures for recording and collecting premiums from the 27 pay offices across the country. Training procedures are well documented. Guidelines for claims adjudication are comprehensive and are updated on a regular basis with current information.

6.54 The insurer charges its actual cost of operating the claims office as an expense to the Plan. We reviewed these expenses and consider them to be reasonable in relation to the size of the Plan. They also compare favorably to industry practice, except that the level of service provided may be lower in some areas.

6.55 **Quality control.** The quality control procedures for processing claims in the GSMIP Ottawa office are weak.

Exhibit 6.2

GSMIP
Potential Annual Cost Savings by Adopting Alternative Financial Arrangements

(in thousands of dollars)

	Insured	Partially Insured	Self-Insured
Improve investment returns on:			
- Surpluses and Reserves	900	900	900
- Cash Float	160	160	160
Eliminate Re-insurance Charges	210	210	210
Decrease in Premium Taxes	-	1,440	1,600
Decrease in Sales Taxes	-	810	900
	1,270	3,520	3,770

Note: This does not include future savings that could be realized from renegotiating profit charges, setting more realistic premium rates, and better monitoring of claims processing procedures.

6.56 Most carriers monitor the performance of the claims assessors by routinely reviewing a selected number of claims for each assessor. The error ratio in each selection of claims is compared to the target error ratio set by the insurer. If the quality of the assessor's work is not within the target limits, specific procedures exist to retrain the assessor or to carry out additional reviews. These procedures are not in place at the Ottawa claims office.

6.57 Regular internal audits are another important part of quality control. An annual audit of a selected number of claims is done by the insurer's internal audit department. In our opinion, recent audits have been too limited in scope to have provided a conclusion on the overall accuracy of the Ottawa claims processing operations.

6.58 We carried out two claims audits. The first audit took place in February 1988 during the peak period, when temporary assessors are hired to help handle the workload. A subsequent audit was carried out in May 1988, during a period of more normal operating activity. The results of both audits revealed an error rate which was significantly higher than the insurer's own target error ratio.

6.59 Incorrect claims payments can lead to increased costs of administration by the insurer, dissatisfied claimants and increased claims costs, and can ultimately affect premium levels.

6.60 **Eligibility of claims.** The results of our review of the systems in place and our detailed claims audits indicate that, in general, claims are being paid in accordance with the terms of the contract. We did note two important exceptions, which are described below.

6.61 **Co-ordination of benefits requirements.** There is a question on the claim form asking the claimant if there is any other insurance in force that may cover all or part of the expenses submitted for payment. However, we noted that if the claimant does not answer this question, the staff of the GSMIP office assume that there is no other coverage in force. In over 30 percent of the claims we examined, the question had not been answered.

6.62 Although there are no related statistics available in Canada, studies completed in the United States indicate that there could be a potential for cost savings of up to 5 percent of paid claims, with aggressive enforcement of the Co-ordination of Benefits clause. Although not all insurers in Canada strictly enforce this, it may well be worthwhile for a plan as large as GSMIP. The potential cost savings could be substantial.

6.63 **Submission of claims.** Contrary to the policy requirement that claims must be submitted within six months following the year in which they are incurred, the insurer, with the concurrence of Treasury Board, will accept claims for the two previous years. This is also contrary to the information contained in the Plan booklet. Treasury Board Secretariat needs to ensure that the policy and the booklet reflect actual practice.

6.64 **Claims processing.** The time for processing claims is higher than the industry norm. The average turnaround times for the claims we reviewed in February and May 1988 were 14 and 10 working days respectively. Although this compares favourably with the target of 15 working days for the Ottawa office during January and February, and 10 working days for the balance of the year, the target turnaround times for processing medical claims by some of the other large insurance carriers range from 3 to 5 days. We understand that the target time for the insurer's other claims offices is about 5 days.

6.65 **Treasury Board Secretariat should discuss with the insurer ways of improving the efficiency of the GSMIP claims operations; in particular:**

- **improving quality control procedures to industry standards and/or negotiated acceptable levels;**
- **enforcing the Co-ordination of Benefits Clause;**
- **amending the policy and Plan booklet to reflect the actual time period allowed for submitting claims; and**
- **reducing claims turnaround times.**

6.66 **Treasury Board Secretariat should establish procedures that provide for regular monitoring of GSMIP claims processing operations and the level of service provided. This should include such things as:**

- **claims turnaround time; the nature and extent of quality control procedures; target error ratios; the method for charging administration costs; and provisions for possible financial penalties and for independent reviews by the Plan sponsor.**

6.67 Treasury Board Secretariat should:

- **obtain regular reports from the insurer that would allow the Secretariat to monitor the efficiency of operations. Such reports would include turnaround time, information on large and unusual claims, claims experience by employer and results of internal audit and quality control reviews; and**

- **carry out regular audits of the insurer's performance.**

DEPARTMENT OF AGRICULTURE
CANADIAN FORESTRY SERVICE

DEPARTMENT OF AGRICULTURE
CANADIAN FORESTRY SERVICE

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7

DEPARTMENT OF AGRICULTURE CANADIAN FORESTRY SERVICE

Main Points

The forest industry is one of Canada's most important industries. Nationally, about one in ten jobs and 300 communities are directly dependent on the forest resource. While the industry is strong, there is increasing concern that the current level of activity cannot be sustained. The objectives of the Canadian Forestry Service are to promote and enhance the use of the forest through research and cost-shared agreements with the provinces. This year's report focusses on the management of these activities. (paragraphs 7.4 to 7.11)

The Canadian Forestry Service needs to strengthen its co-ordinating role in managing, controlling and implementing the Forest Resource Development Agreements. (7.14)

Despite the expenditures under the Forest Resource Development Agreements, the backlog of unsatisfactorily restocked forest land in Canada continues to accumulate, although at a reduced rate. (7.15)

Program planning and delivery procedures do not always ensure that funds are being spent in accordance with agreement guidelines. The Canadian Forestry Service has yet to establish a complete national data collection system to monitor and report the status of Canada's forests. (7.17 to 7.20)

The Canadian Forestry Service needs to improve its cost records for its main program activity -- conducting research. (7.43)

DEPARTMENT OF AGRICULTURE
CANADIAN FORESTRY SERVICE

Background

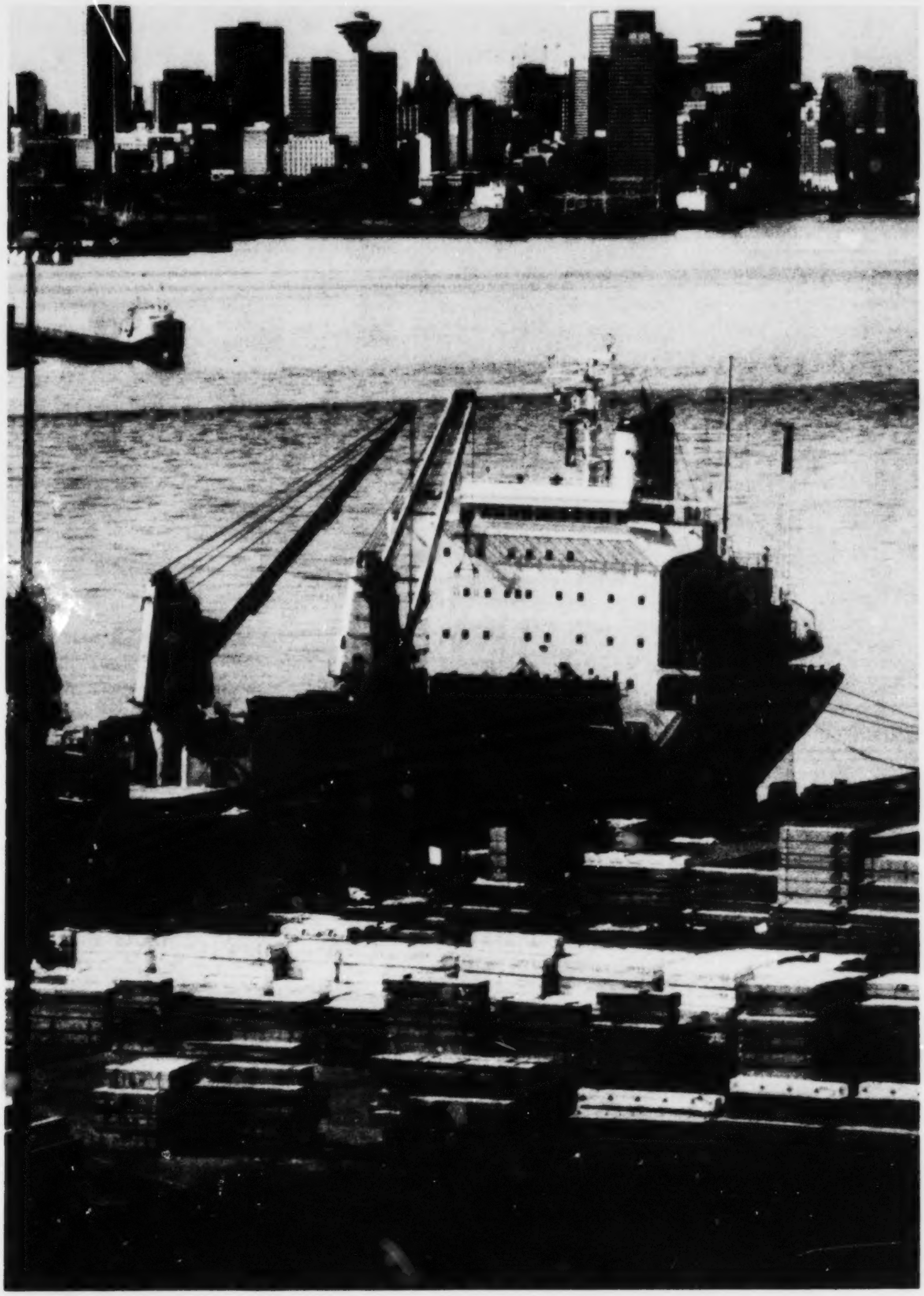
7.1 In 1960, Parliament established a separate Department of Forestry. Since 1966, however, it has been combined with a variety of other government departments. After having been reorganized as the Department of Forestry and Rural Development in 1966, it was combined with the Department of Fisheries and Forestry in 1968, with the Department of the Environment in 1970, with the Department of Fisheries and Environment in 1976, and with the Department of Agriculture in 1984. Over the past 20 years, the size of the Canadian Forestry Service (CFS) has been reduced from a high of 2,181 person-years in 1968 to 1,255 person-years early in 1988.

7.2 Under the current legislative arrangement, the Minister of State for Forestry reports to the Minister of Agriculture; the Associate Deputy Minister for the Canadian Forestry Service reports to the Deputy Minister of the Department of Agriculture. The Associate Deputy Minister is responsible for day-to-day management of forestry operations under the authority of an "Instrument of Delegation" from the Deputy Minister. Within this reporting relationship, the final authority relating to CFS activities rests with the Department of Agriculture. (Exhibit 7.1)

7.3 Under the Constitution Act of 1982, forestry is primarily a provincial responsibility. Thus the Service's activities are directed largely to supporting the provinces which, according to Canada's Forest Inventory of 1981 (the most recent available), own approximately 80 percent of Canada's 2.2 million square kilometres of inventoried productive forests. Private landowners account for about 8 percent, and the remaining 12 percent is under federal jurisdiction.

7.4 The objectives of CFS, as stated in the Forestry Development and Research Act of 1966-67, are to promote and enhance the sustained economic use of Canada's forest resource through environmentally sound forest management; and to enhance the social and economic benefits derived from publicly and privately owned forests and from forest related activities in Canada. To achieve these objectives, CFS conducts research in protection, management and utilization of the forest resource, enters into cost-shared agreements with the provinces to implement forest management programs, and establishes experimental areas for forest research.

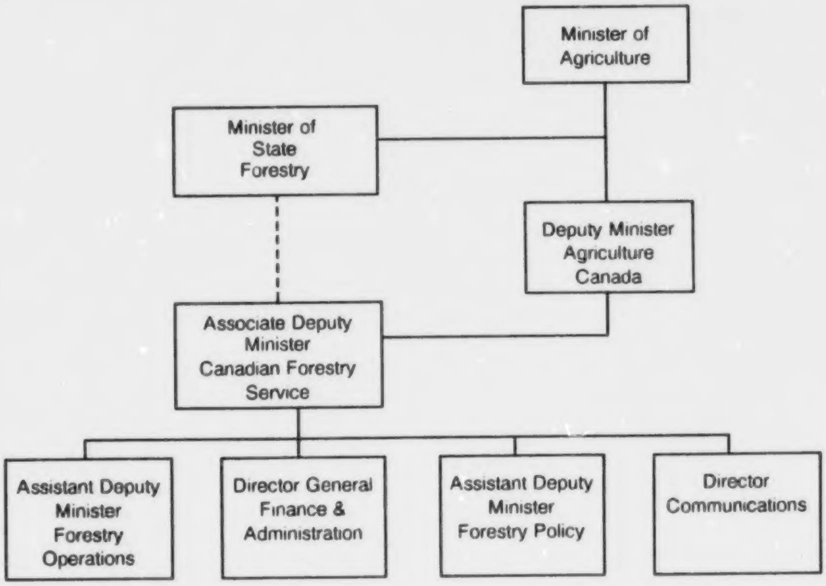
7.5 Two national institutes and six regional centres, as well as a headquarters unit, make up the Canadian Forestry Service. The two national institutes conduct research on forestry matters relevant to the country as a whole; regional centres carry out research primarily on local issues. Since much forestry research is a function of geographically specific conditions of vegetation, climate and soils, the decentralization of research mirrors the ecological variety of the Canadian environment.



Forestry exports produce an annual export surplus of $16 billion (see paragraph 7.6).

Exhibit 7.1

CANADIAN FORESTRY SERVICE
ORGANIZATION CHART

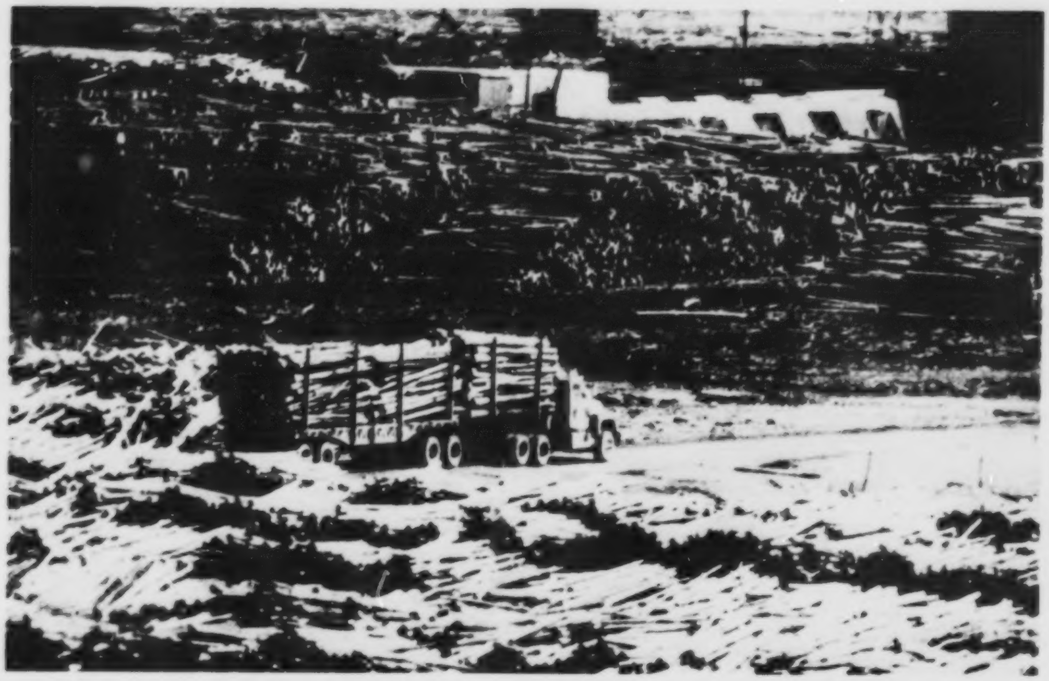

Minister of Agriculture
Minister of State Forestry
Deputy Minister Agriculture Canada
Associate Deputy Minister Canadian Forestry Service
Assistant Deputy Minister Forestry Operations
Director General Finance & Administration
Assistant Deputy Minister Forestry Policy
Director Communications

Forestry in Canada

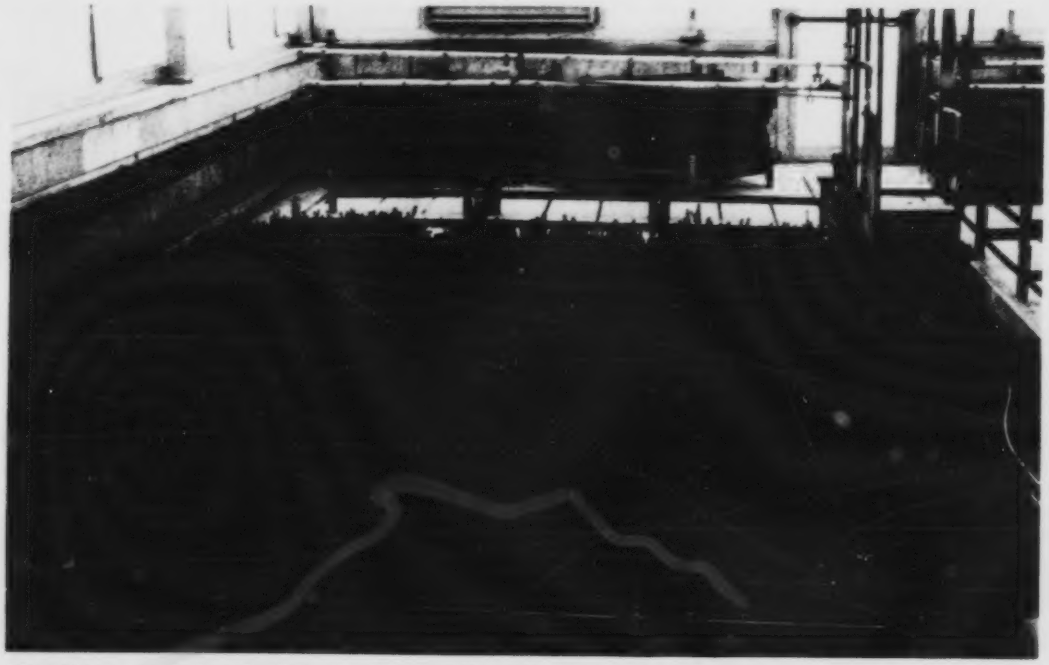
7.6 The forest industry is one of Canada's most important industries. Nationally, according to Statistics Canada, about 1 in 10 jobs and 300 communities are directly dependent on the forest resource, which has an annual value of about $33 billion in goods shipped. The industry is also Canada's leading export sector, accounting for an annual net trade surplus in this sector of around $16 billion.

7.7 While the Canadian forest industry is strong, there is increasing concern that the current level of economic activity cannot be sustained. Lack of adequate forest management in the past has resulted in depletion of the forest resource. Significant shortages of wood are now reported at the local level in every province. Restocking of productive forest lands has not kept pace with the harvest, and this threatens future forest productivity. Given the importance of the industry to Canada's economy and social structure, it is clear that any significant decrease in the supply of wood will have a serious impact on all Canadians.

7.8 Decisions on investment in reforestation and better management of the resource are dominated by three considerations. First, the enormous size and dispersal of the forest demand large expenditures for forest management. Second, federal investment in forestry usually also involves the provinces. And last, the growing cycle for a mature forest involves a 40-to-80-year time span. A decision to manage or invest in forestry reflects a commitment



One of the many Canadian wood processing mills (see paragraph 7.7).



Seedlings ready for planting. It will take 40 to 80 years before these trees are ready for harvest (see paragraph 7.8).

to a long-term view of the resource. Those who invest money and careers are unlikely to see, in their lifetimes, the results of their efforts reflected in a mature forest ready for harvest. For these reasons it is essential that CFS actively promote the implementation of management systems which recognize the long life cycle of forest renewal.

7.9 The CFS, through the Canadian Council of Forest Ministers, has assisted in developing and implementing the Forest Sector Strategy for Canada. Through its research program, it has made some significant contributions to forestry; for example, its fire control systems have had wide recognition and, more recently, it has developed an environmentally safe method of controlling the spruce budworm. Its involvement in the Forest Resource Development Agreements has contributed to an increase in reforestation. However, as described in the following paragraphs, the delivery of its programs could be strengthened.

Audit Scope

7.10 This is our first value-for-money audit of the Canadian Forestry Service. We concentrated on its two main activities: Forestry Development, which relates primarily to the Forest Resource Development Agreements; and Research and Technical Services. Under the Forest Resource Development Agreements, transfers to the provinces were $131 million (59 percent) of the total 1987-88 budget of $221 million; Research and Technical Services, which employed 65 percent of CFS's personnel, received approximately $61 million (28 percent). Together, the two activities used 78 percent of personnel and 87 percent of CFS expenditures. Administration cost about $29 million (13 percent). (see Exhibit 7.2)

7.11 The audit reviewed the management of the Forest Resource Development Agreements, using information available within CFS. More specifically, we examined current management controls for the agreements, procedures employed to deliver the programs, and operating procedures' consistency with legislation, using our established audit criteria for contribution agreements. We also examined the management of Research and Technical Services, using our established criteria and the guidelines published by the Office of the Comptroller General in 1985.

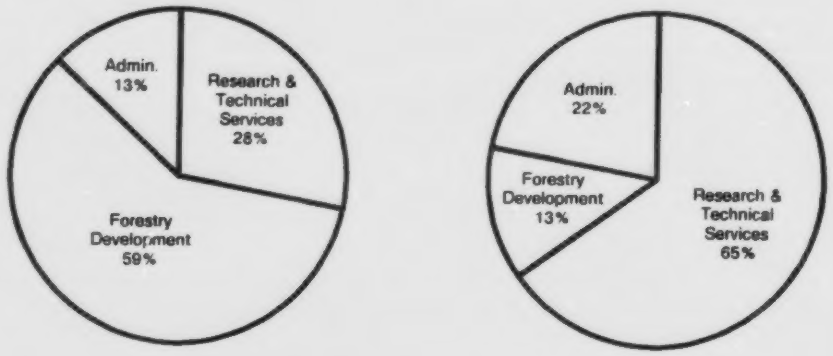
Forest Resource Development Agreements

7.12 Following Cabinet approval of a "Forest Sector Strategy for Canada" in 1981 and Agreement Guidelines in 1982, the Government of Canada began implementing this strategy by entering into Forest Resource Development Agreements with each province. Between 1982 and 1989, the agreements will direct over $1 billion in federal and provincial funds toward four activities: regeneration of harvested lands and areas which have been damaged by fire, insects or disease; intensive forest management of existing stands; forest management research; and public communications. CFS is not involved directly in such issues as the annual allowable cut, allocation of timber or land use policy.

7.13 The federal share of funding under all Forest Resource Development Agreements will be $612 million – 54 percent of the total. As of 31 December 1987, approximately $320 million in federal funds had been spent. The agreements are administered by management

Exhibit 7.2

CANADIAN FORESTRY SERVICE
1987-88 RESOURCES



Program Dollars

Total 1987-88
$221,654,000

Person-years

Total 1987-88
1,255 PYs

committees comprised of provincial government representatives and senior CFS managers. With the exception of some $191 million in federal direct delivery programs, most forestry development work is performed by the provinces on a cost-shared basis.

Co-ordination

7.14 Our review indicated that CFS should exercise a stronger co-ordinating role in managing, controlling and implementing the Forest Resource Development Agreements. While these agreements differ from province to province, it is important that CFS provide strong leadership and co-ordination in implementing forest strategies to ensure the availability of future wood supplies. CFS believes that the agreements have generally had a positive impact on forestry practices; however, the impact varies from agreement to agreement. Better co-ordination is required to ensure that improved forestry practices are applied more consistently, leading to an increase in the resource base across Canada.

Backlog

7.15 In addressing Canada's economic supply of wood, one of the major government objectives under the Forest Resource Development Agreements is to reduce the backlog of unsatisfactorily restocked forest land in Canada. Our review indicated that this objective is not being achieved. Under the agreements, approximately 50 percent of funds are directed to reforestation. CFS has reported that, since 1982, some 470,000 hectares of land have been reforested under the agreements. However, CFS estimates that the amount of unsatisfactorily restocked forest area continues to increase, although at a slower rate.

7.16 Further, the agreements do not clearly indicate whether reforestation funds are to be used to reduce the cumulative backlog or applied to land needing restocking because of the current forest harvest. CFS does not have enough information, or a national system in place, to be able to comment on the national forest resource. Specifically, the information available on a national basis is insufficient to determine how much the wood supply will be improved by expenditures in reforestation or intensive forest management.

Guidelines

7.17 Current program planning and delivery procedures do not ensure that funds are being spent in accordance with guidelines in the agreements. Each agreement contains guidelines for carrying out various types of forest development work. Our review of five agreements indicated that these guidelines are not consistently followed. Between 1985 and 1987, for example, CFS found that $10.5 million of $15 million in plantation expenditures under one agreement was spent on sites not in compliance with "distance" guidelines. In only two of the five agreements were local and regional plans in place outlining the work to be done under the agreements and how it related to overall forest development strategies. Our conclusion, and that of the Department's Internal Audit, is that agreement implementation guidelines do not provide an adequate mechanism for national control purposes.

7.18 Forestry development work is not always carried out with sufficient regard to economy and efficiency. The general intent of the Forest Resource Development Agreements is to ensure that funds are spent on the most productive sites and that these receive appropriate silvicultural treatment. Although these decisions need to be based on an assessment of the relative potential of the sites and an economic assessment of various forest treatment options, we found few instances where this had been done.

7.19 Based on a review of reports available within CFS, we found insufficient pre-treatment assessment and monitoring of forest development work. This has resulted in treatments being applied to marginal sites, incorrect site preparation, poorly planted sites and the planting of inappropriate tree stock. Under three out of five agreements, silvicultural work was conducted on forest areas designated by CFS as being too small to represent an economic or efficient allocation of funds. Although all applicants must meet basic criteria, forest development work on private lands is generally first come, first served, without setting priorities according to a needs assessment. Such practices do not meet generally accepted procedures for ensuring due regard to economy or efficiency in the expenditure of funds. Data on all agreements were not available and we could not determine the extent of these deficiencies.

Data

7.20 The Canadian Forestry Service's national data collection system is not yet adequate to monitor and report results under the agreements. The collection of accurate information on a national basis is essential to the long-term management of Canada's forest

Much of the planting is done by hand. But assessments are not always being made of the appropriateness of reforestation sites or of the best planting options (see paragraph 7.19).

resource, and should reflect both the renewable life cycle of the resource and the time-frame within which funding decisions are made. Current CFS procedures for monitoring the results achieved under the agreements do not provide adequate data on growth and yield for areas undergoing intensive forest management, or on survival rates in reforested areas, or to predict the availability of future wood supplies.

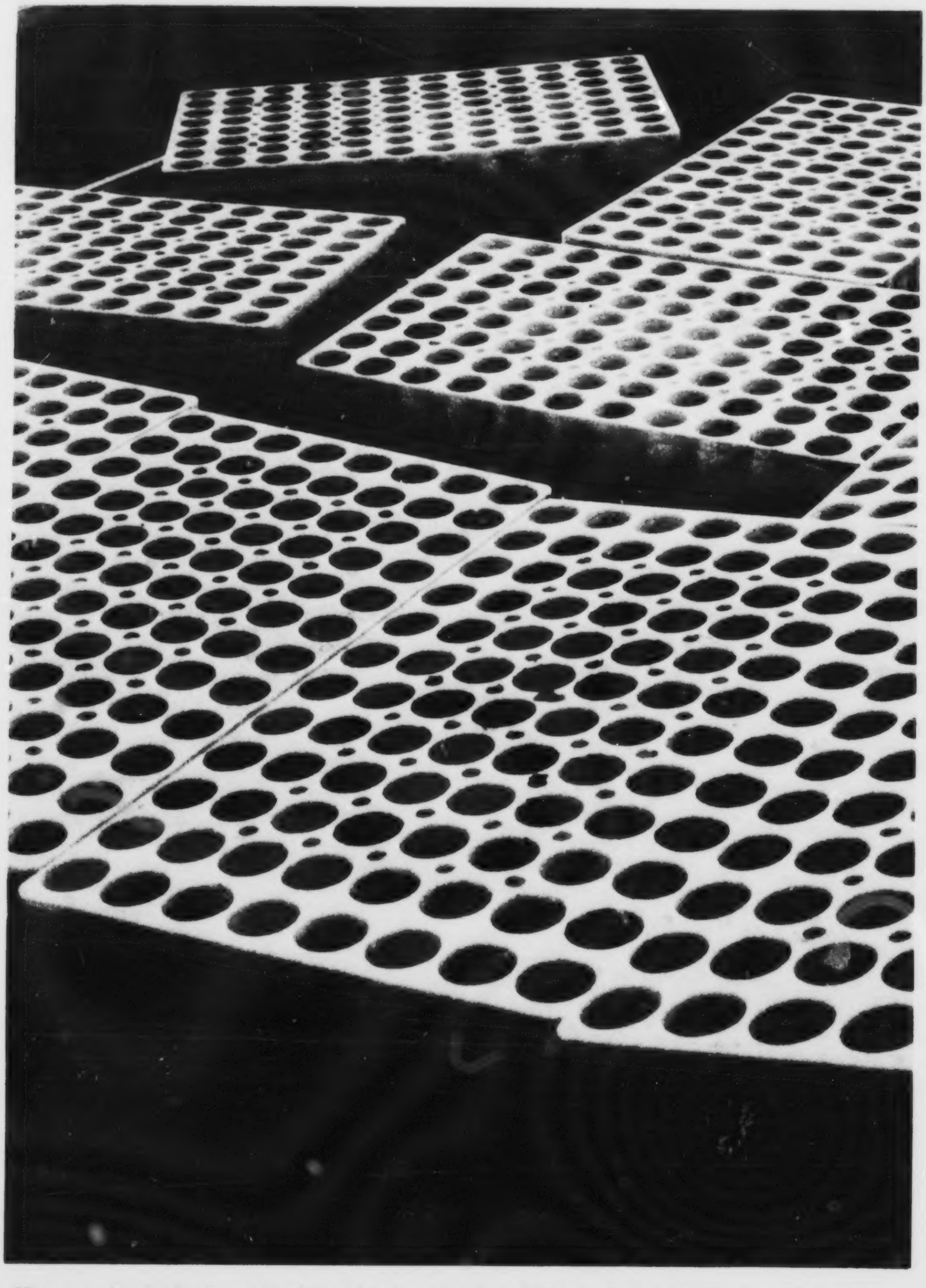
7.21 The Forest Resource Development Agreements do not contain clear standards for collecting data on reforested areas or for follow-up work. Due to inconsistent reporting practices, it was not always possible to determine the magnitude of plantation successes and failures or the extent to which sub-optimal sites were selected for forest development work. In general, the survival rate of seedlings in plantations is directly related to timely silvicultural treatments designed to control and eliminate competitive plant growth, thus helping the seedlings to become mature trees. Normal forestry practice suggests that two to three treatments are required during the first 10 years of growth. Since this treatment schedule extends beyond the term of an agreement, which is usually five years, only a small proportion of reforested areas will receive funding for such care during the term of the agreement. If such care is not provided, there is a high risk that seedlings planted during the agreements will not survive. This could have a substantial bearing on the future supply of wood fibre.

7.22 Although an evaluation of their effectiveness is a stated requirement of the agreements, this information will not be available to CFS in time to take appropriate action where required. Some agreements require an evaluation to take place within the first three years, while all of them require evaluations at the end of the five-year term. Many agreements do not yet have a clear yardstick for evaluation, or the evaluations have been deferred.

7.23 **The Canadian Forestry Service should:**

- **clearly establish its acceptance of existing standards for reforestation and intensive forest management funded by the Forest Resource Development Agreements or modify or develop these where necessary;**
- **implement procedures to ensure that agreement guidelines are being followed; and**
- **develop a national system for collecting and reporting, on a consistent basis, timely and accurate information on Canada's forest resource and its management as a basis for the negotiation and monitoring of future forest agreements.**

Management response: *We agree. Comprehensive standards have been developed by the provinces, and in some cases with industry or the Canadian Forestry Service as a result of the agreements, to govern silvicultural operations on provincial Crown lands. In the case of private, federal and Indian lands, the CFS has either developed standards of its own or adapted provincial standards, as appropriate. CFS will ensure that these standards are formally adopted by the respective management committees for each agreement in 1988-89.*



New growing technology developed by the Canadian Forestry Service (see paragraph 7.25).

Also, the CFS will review its existing mechanisms and procedures to ensure that agreement guidelines are being followed. CFS will reassess these guidelines to determine if revisions or additional mechanisms are needed.

The CFS has several national initiatives under way to improve its resource data, including a national forest inventory, the development of a national wood supply and demand analysis, and a management information system to report progress under the agreements. CFS assesses the contribution of the individual agreements to resolving the wood supply issue on a province by province basis and will continue its efforts to improve this process both locally and nationally. The CFS also will continue to strengthen its links with provinces and industry as this is essential to improving the forest resource data available on a national basis.

Research and Technical Services

7.24 CFS is the major player in forestry research in Canada, with headquarters and regional research centres performing different management roles. The headquarters role includes reviewing national and regional work programs, assessing national CFS resource allocations and developing national policy.

7.25 The regional centres conduct research projects and liaison with provincial, academic and industrial contacts in their respective regions. Research encompasses a wide range of areas: meteorology, climatology, hydrology, tree and seed physiology, biotechnology, genetics and tree improvement, forest ecology and soils, silviculture, growth and yield, remote sensing, forest fire management, insect physiology, epidemiology and pesticides. The work of the regional centres is therefore largely scientific and professional. Many CFS researchers have made distinguished contributions to the literature in their fields and are considered international leaders.

7.26 Research findings are the primary outputs from an annual expenditure of $61 million on research, mainly on salaries for the approximately 826 professional and support staff. Highly qualified people are the main resource of the forestry research establishment. The management of this resource is a major factor in obtaining maximum value for the money spent on research.

Objectives

7.27 The Canadian Forestry Service does not have a fully developed framework for setting research priorities or a clear set of operational guidelines for applying the results of its research. Research findings presented in papers and journal articles are still the primary basis for judging the productivity of scientific personnel. This method of assessing performance is accepted procedure within the scientific community and the public service staff appraisal process. As a result, research scientists tend to view their projects as being more directed to creating knowledge than applying it.

7.28 CFS does not have direct responsibility for managing most of Canada's forests, and the client base for its specialized research knowledge is often not documented at the project level. All projects are assumed to have existing or potential clients, but there are no formal procedures to ensure this linkage. While there may be opportunities for commercial development or other applications of research findings, current project management procedures do not include a periodic assessment of how these opportunities could be exploited.

7.29 The field application of CFS research findings often requires direct technical support of client groups by the researcher involved, and there is a gradual movement to integrate client support activities as a component of the staff appraisal process. Scientists do not always receive adequate recognition for this important work, nor is responsibility for client-researcher interface, necessary for technology transfer, formally assigned. Weaknesses in technology transfer procedures and the implementation of mission-oriented research indicate that CFS is not always in a position to ensure that it is obtaining maximum value for money for its research expenditures.

7.30 **The Canadian Forestry Service should implement guidelines to assist both managers and scientific staff in clearly defining the specific client groups to whom it provides research services.**

> ***Management response:*** *We agree. CFS has a firm understanding of its clientele and involves them directly in the priority setting process through active participation in advisory committees, project reviews and joint studies. The extent of this client collaboration, while essential for the successful conduct and application of CFS research, often has not been fully documented. Beginning in 1989-90, CFS will ensure that clients are clearly identified and documented.*

Project Selection and Review

7.31 Research projects are chosen if they meet one or more of the following criteria: a clearly identifiable problem in the forest; an ongoing line of inquiry previously established within the scientific community; or advisory committee suggestions. Once a project is initiated, however, performance is judged primarily on the way in which the research is conducted and researcher productivity in publishing results.

7.32 To assist management in reviewing research projects, CFS uses peer review committees comprised of experts in the type of research being carried out. While this process appears to work well on specific projects, researchers do not always comply with the recommendations of the peer review committees. Neither CFS nor the peer review committees specifically document the assessment of projects to determine the extent to which thev are contributing to national or regional program objectives.

7.33 **The Canadian Forestry Service should periodically review all research activity to maximize its:**

- **application to forest management practices;**

- **value to industry; and**
- **contribution to CFS program objectives.**

> ***Management response**: The CFS has a number of review mechanisms to ensure that its research makes optimum use of limited resources and is relevant and responsive. These include multi-agency advisory committees at national and regional levels; formal review of projects; periodic revision of the strategic plan; and the continuing examination of needs and priorities by working groups of scientists.*
>
> *To strengthen its review mechanisms, the CFS in 1988-89 will implement the Research Program Assessment Process. This will systematically consolidate and reinforce existing procedures and focus on projects within a program area. It will examine relevance to identified priorities, identification of clients, adequacy of technology transfer and anticipated economic and environmental benefits. All program areas will be reviewed on a four-year cycle.*

Technical and Scientific Information Dissemination

7.34 CFS publications and forest research articles must meet rigorous scientific standards, but the practical implications of research are generally not presented in a format useful to a practicing forester. While there have been various recent initiatives to make CFS work available to the forest industry, this function is not consistently performed. As a result, practicing foresters and the industry do not always view CFS research as being of immediate practical value.

7.35 The Canadian Forestry Service should review its information management role with particular emphasis on the use and dissemination of research findings.

> ***Management response**: We agree. Effective dissemination of research findings is an integral part of CFS' research activities. Technology transfer to clients, which is vital to this process, is being strengthened through more joint projects with industry and provinces, implementation of advisory committee recommendations and technical workshops. As well, increased emphasis will be placed on technology transfer in project reviews and the new Research Program Assessment Process to be initiated in 1988-89.*

Planning

7.36 In 1986, CFS began implementing a new Rational and Integrated Planning System (RIPS) to provide an overall corporate basis for priority setting and resource allocation. The system involves preparation of a Strategic Plan, Operational Overview Directives, Corporate and Regional Operational Overviews, Work Plans and Quarterly Reports.

7.37 Within this new system, CFS planning decisions are made following senior management's review of previous years' plans and discussions with advisory councils representing industry, provincial governments and the scientific community. However, CFS is not always in a position to make planning decisions grounded in an assessment of the economic dimensions or the reasons for previously successful operations.

7.38 At the regional research centres, project plans prepared by individual researchers are the primary operational control documents. Generally, no detailed studies or analyses are done on the expected economic benefits of current or planned research projects compared to their costs. Research centre work plans are a roll-up of project plans. Regional research centres have a great deal of autonomy in selecting research projects and allocating their resources. CFS headquarters reviews to what extent the combination of regional work plans meets national objectives and, where necessary, initiates changes in the regional work plans.

7.39 CFS has implemented a computer-assisted system into which detailed work plans are entered for future reference, updating and reporting. However, there is no procedure to ensure the updating of the computerized planning data base throughout the year, to reflect progress in reaching goals. Similarly, there is no assurance that new developments, program evaluations or peer reviews will be recorded and considered in future priority setting or resource allocation decisions.

7.40 The Canadian Forestry Service should incorporate program performance data and cost benefit analyses of its research efforts in future planning decisions.

> ***Management response:*** *The CFS is highly decentralized to respond effectively to regional issues. Through its strategic plan and operational overview directives, it establishes new national priorities and ensures their implementation. The CFS is refining comprehensive performance data as set out in the Operational Plan Framework and will consider this in addressing national objectives through the CFS planning system beginning in 1989-90.*

Financial Management and Control

7.41 With 1987-88 operating expenditures estimated at $76.2 million, adequate financial management and control are important if CFS is to obtain maximum value for money spent on research. We therefore reviewed the financial systems and procedures used by Research and Technical Services to ensure that financial resources are adequately controlled and systems and procedures are appropriate. This review included the budget management and control process, financial controls over expenditures and revenues, asset management, financial reporting and the role of the financial function.

7.42 Budget preparation is based largely on historical resource use. Items such as salaries, accommodation, communications, motor vehicles and related costs are controlled at each regional centre. Research project budgets are prepared annually for each research project in line with approved work plans and funding levels. These project budgets are subject to careful scrutiny and control but they do not reflect the total cost of the research; they do not include items such as computers, vehicles, equipment and support staff. Budgetary control consists mainly of keeping accurate records of direct expenditures, commitments and budget transfers, and producing financial variance reports on a regular basis.

7.43 The Canadian Forestry Service needs to improve its financial records for its main program activity – the conduct of research. Neither headquarters nor the regional research centres keep adequate records of all costs for significant items such as computers, accommodation and salaries attributable to individual studies. Some research projects are initiated and funded without consideration of the capital and operational budgets necessary to carry them out in accordance with initial project design. Scientists may make modifications to project design without documenting the changes or ensuring that they are reflected in the budget. More important, costing of research projects is rarely reviewed in relation to results.

7.44 The Canadian Forestry Service does not have financial or administrative data on specific research projects reflecting their cumulative costs. Although some forest research sites have been continuously monitored for more than 50 years, their full value is not assessed regularly, nor are they managed as an investment and treated accordingly.

7.45 Detailed regional financial reports are prepared for senior managers at least monthly. These locally designed reports show budgeted versus actual expenditures; they do not show what operational results on research projects were expected or what was actually achieved. Only year-to-date costs are shown, and no comparative figures are given for the previous year. Monthly financial reports do not show costs of studies or projects since their inception, nor do the financial systems retain this information. Such financial information is essential for research on forests with a long life cycle.

7.46 Senior regional financial officers view their role mainly as keepers of accounting records and do not perform detailed cost analyses relating to specific research initiatives. No special training is provided to financial officers to assist in these analyses. As a result, financial officers do not provide management with sufficient information or advice on the financial implications of research decisions.

7.47 **The Canadian Forestry Service should record and maintain more complete current and cumulative cost information for each research project and assess the potential cost benefits of research devoted to specific lines of scientific inquiry.**

> ***Management response:*** *We concur. The CFS will undertake a review of project budget and cost allocation procedures to improve the financial data available to management to make decisions on resource allocations to projects. Changes to improve the quality of information available to managers will be incorporated into the financial and operational planning systems beginning in 1989-90.*
>
> *The responsibility for the assessment of potential cost benefits of research projects will be reviewed and assigned to the appropriate organizations within the CFS beginning in 1989-90.*

Electronic Data Processing (EDP)

7.48 CFS investment in EDP equipment has increased significantly to over $13 million in the past four years. Although regional establishments contribute to the annual Information Technology Systems Plan prepared by the Department of Agriculture, each centre manages its computer resources independently. New computer hardware acquisitions are funded from the regional capital budgets, where they must compete with other requests for capital acquisitions. Purchases of computer resources have absorbed a major share of the regional centres' annual capital budgets in the past three years.

7.49 Research centres determine their own computer resource requirements for their specific mix of scientific and non-scientific applications. Computer resources are managed with little headquarters direction or co-ordination. Many centres have recently upgraded their central computer resources and can point to significant achievements in implementing and applying personal computer and office automation systems.

7.50 In the modern scientific research environment, computers are an indispensable tool. Many researchers write and maintain their own computer programs. These skills are particularly important since there are few regional EDP personnel to provide computer support services. Computer usage costs, however, generally are not charged to the budgets of individual users, although the extent of use is monitored for planning and control purposes.

7.51 Headquarters has not provided sufficient leadership in the development of CFS computer systems. Regional centre computer support resources were largely used for the development of local financial and administrative systems which were unique to each region. This arrangement led to a significant duplication of cost and effort, and little sharing of data. We have been advised by CFS officials that a National Informatics Co-ordinator has recently been appointed to remedy these deficiencies.

Human Resource Management

7.52 CFS is subject to the Department of Agriculture's human resource management policies. While there is a memorandum of understanding on personnel services between the two organizations, operational arrangements are not yet fully implemented after almost four years. For example, the Department of Agriculture Multi-year Human Resources Plan does not include a section on the Canadian Forestry Service.

7.53 The current CFS human resource planning process does not identify the quantity or type of human resource skills required to achieve program objectives or consider their availability. There is little reliable data available about turnover rates, attrition rates or potential retirements. Although regional research centres have reported that a large percentage of scientists are eligible for retirement within five years, there is no systematic approach to determining how these scientists will be replaced, including what skills will be needed and when. Given the central role of CFS in Canadian forestry research, the need for an effective human resource planning system is clear.

7.54 Performance review and appraisal is an integral part of the human resource management process. However, our review indicated that, at regional centres, the completion rate of performance appraisals for researchers varied considerably. When appraisals were completed, there were great differences in quality. Several members of the Management Category received an award for superior performance without completed appraisals on file.

7.55 CFS should establish and implement appropriate procedures for the management of human resources at headquarters and all regional centres.

> ***Management response:*** *We agree. The Canadian Forestry Service is developing procedures for the management of human resources which will be implemented within the framework of CFS' planning system. This implementation should be completed in the coming fiscal year.*
>
> *CFS will utilize the Human Resources Information System developed within Agriculture Canada. This should be accessible by 31 March 1989.*

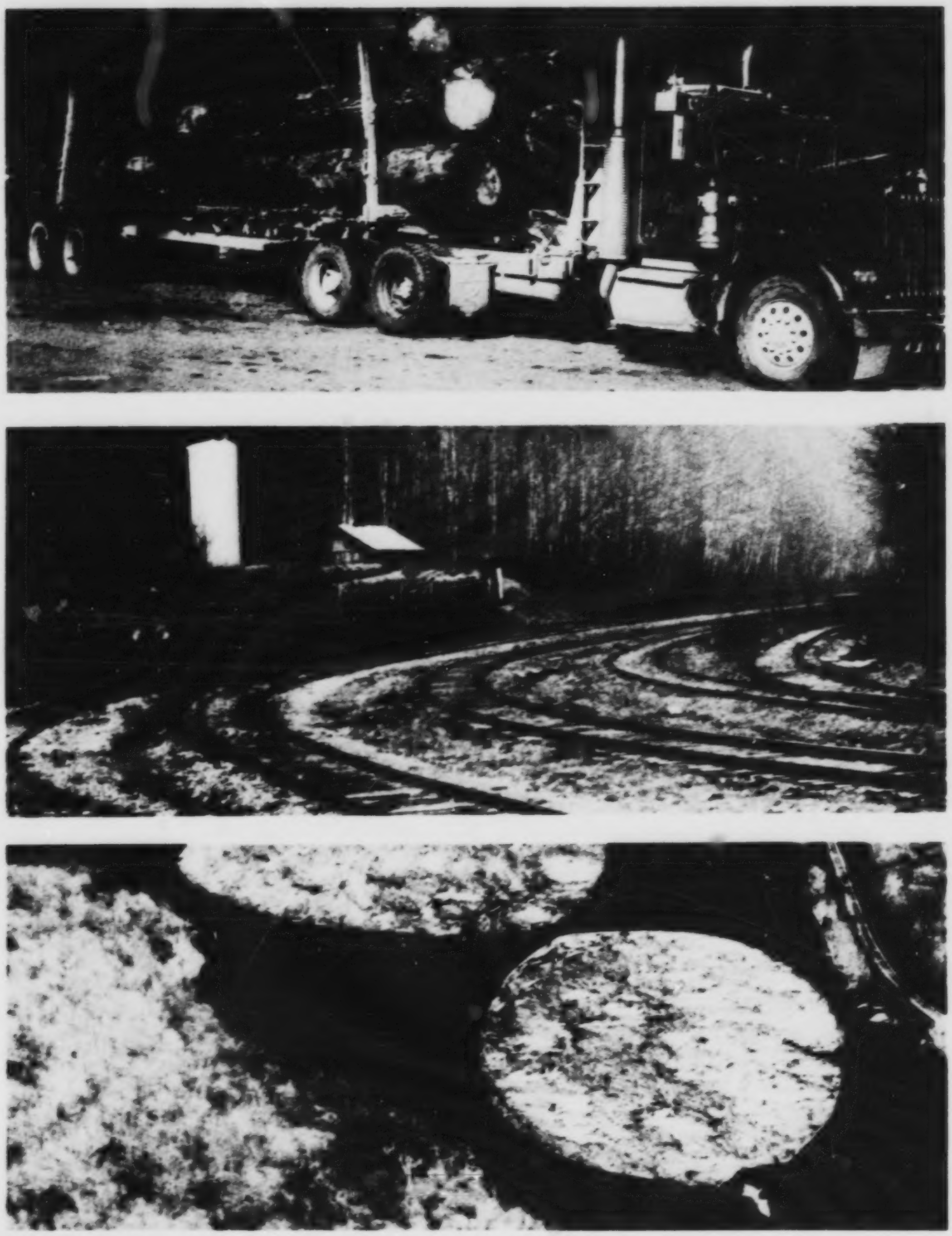
Effectiveness Measurement

7.56 CFS has not carried out sufficient evaluations or collected the performance data needed to measure the effectiveness of its program activities. All Forest Resource Development Agreements contain a program evaluation requirement. Levels of evaluation activity, however, are uneven across the country, and reliance is often placed on information gathered without sufficient CFS involvement. Following our examination of a sample of evaluation reports at CFS regional centres, we are concerned about the large variations in the quality of information collected and the amount of analytical review.

7.57 Agriculture Canada has carried out only one major program evaluation of CFS research activity in the past four years. This covered less than five percent of research expenditures for the period under review. Also, the criteria used to select research initiatives did not ensure that the findings would be typical of the broad range of research activities.

7.58 The Canadian Forestry Service should establish clearly defined procedures for measuring and reporting on the effectiveness of its activities.

> ***Management response:*** *We concur. The CFS measures the effectiveness of its research activities through the program and project review reports. As indicated in the management response to paragraph 7.33, the CFS is implementing a Research Program Assessment Process which will ensure that all program areas of research are reviewed systematically beginning in 1988-89.*
>
> *Evaluations of forestry development agreements are carried out in keeping with Treasury Board guidelines and a CFS national directive on agreement evaluation. In 1988 the CFS also will be undertaking a national program evaluation in concert with the departmental evaluation group.*
>
> *To strengthen its corporate evaluation capabilities, CFS is in the process of clarifying the needs, roles and responsibilities of its evaluation function, in response to the 1988-89 Operational Overview Directives. This will ensure a coherent and consistent overall approach to evaluation within the CFS.*



Parliament and the public need better information on the state of Canada's forest resource and prospects for the long-term supply of wood (see paragraph 7.64).

Information to Parliament

7.59 The purpose of Part III of the Estimates is to provide Parliament with up-to-date and accurate information about a department's programs, comparisons between planned and actual results and expenditures, and other performance data about departmental activity. The information to Parliament contained in the Part III for 1987-88 accurately reflects the structure and activities of the Canadian Forestry Service. However, largely because of the use of jargon and a general failure to provide meaningful performance indicators, the detailed information is difficult to understand.

7.60 Information on specific activities is dispersed throughout the document. For example, the 1987-88 Part III refers to the Forest Resource Development Agreements on 12 separate pages and gives related financial information on 18 others, although it is hard to find specific information about any particular agreement. Confirmation of the dispersal of information is found in the number of page references. Within a 46-page text, there are 36 cross-references to other pages. In many cases, these merely duplicate the same information.

7.61 The Part III also contains some factual errors and misleading statements. For example, the 1987-88 Part III states that: "Canada's total area of productive forest land is about 220 million hectares. Of this amount, approximately 12 percent has not been adequately restocked and this is increasing by 200,000 hectares, or almost 1 percent per year". From this data one would conclude that 88 percent of Canada's productive forest land is adequately stocked. CFS does not know if this is so. Furthermore, one could assume that next year the percentage of inadequately restocked land will be 13 percent, and 14 percent the year after. Close scrutiny reveals that 200,000 hectares is in fact a bit less than one thousandth of the total forest area, and that next year's rate therefore will be 12.1 percent. Such differences have dramatic implications for the long-term supply of wood.

7.62 The Part III does not offer consistent data from prior years or provide an adequate comparative base for CFS achievements. An example is the information on unemployment: "Over the past 10 years, the rate of unemployment in forest industries has dramatically increased from 11.5 to 14.3 percent ...compared with the current national average of 10.5 percent." The previous year's Part III reported that: "Over the past 10 years, the rate of unemployment in forest industries has dramatically increased from 19.4 to 36.4 percent ...compared with the current national average of 10.4 percent." We were advised that the figures reported in the earlier Part III were incorrect. Also, these statements do not indicate that during this 10-year period, the national unemployment rate rose from 7 to 10.5 percent.

7.63 In the statement of cumulative achievements under the Forest Resource Development Agreements, CFS reports that 320,000 hectares received some silvicultural treatment other than reforestation. A summary of the achievements under the individual agreements, however, shows that 540,000 hectares received such treatments – a discrepancy of 220,000 hectares.

7.64 Most significantly, Part III provides insufficient information on the achievement of program objectives. Given the importance of the forest industry in Canada, there is relatively

Disease and fire destroy as much forest every year as the annual harvest yields.

little information to assist Parliament in making judgments on national CFS program priorities or on how successful CFS has been in meeting its objectives. For example, there is little information on employment levels, economic benefits of research and the state of the Canadian forest resource. Multi-year information on such things as the availability of wood supply, production, industry trends, tax revenues and international trade factors would give Parliament a better understanding of Canada's largest industry sector, its forests.

7.65 The CFS Part III should

- **simplify the presentation of information by reducing the use of jargon and complex explanations, making it understandable to those without detailed knowledge of forestry and government operations;**
- **when necessary, provide technical details in supplementary material;**
- **identify and present information on the overall status of the forest sector;**
- **provide statements of achievements in relation to program objectives; and**
- **provide consistent and accurate information from year to year.**

***Management response**: We concur. The CFS will continue to make every effort to present its information in the Part III of the Estimates in clear, understandable and accurate terms consistent with the guidelines issued by the Office of the Comptroller General.*

DEPARTMENT OF AGRICULTURE
FOOD PRODUCTION AND INSPECTION BRANCH

DEPARTMENT OF AGRICULTURE
FOOD PRODUCTION AND INSPECTION BRANCH

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8

DEPARTMENT OF AGRICULTURE FOOD PRODUCTION AND INSPECTION BRANCH

Main Points

We were impressed by the dedication of the Food Production and Inspection Branch's management and inspection staff, and by the high regard in which the Branch is held internationally. This reputation is important for Canada's trade.

The Branch shares responsibility with industry and with provincial and other federal departments for the safety, health and wholesomeness of agricultural food products. It conducts a wide range of activities to protect the health and safety of Canadians and the viability of large sectors of Canada's food, plant and animal industries. Work remains to be done to fully determine which risks are most serious, so resources can be better concentrated where risk is greatest. (paragraph 8.2)

The Branch needs to strengthen several key inspection practices to provide reasonable assurance that human health and safety threats posed by chemical and bacterial hazards associated with food and agricultural products are prevented or removed. Although it does extensive sensory inspections, it needs to use additional laboratory testing, generally the only way of detecting these hazards. (8.26 to 8.40, 8.44 to 8.48)

Current procedures for registering and regulating pesticides need strengthening to provide reasonable assurance that all pesticide products used in Canada are effective and pose minimal or no risk to human health and the environment. (8.49 to 8.65)

There is a need to reduce shortcomings in import inspection standards and practices to reduce Canada's vulnerability to the introduction of foreign animal or plant disease. The Animal Health program has been internationally recognized for eradicating brucellosis and tuberculosis in cattle. But the Branch is not actively involved in controlling many of the plant diseases and – in recent years – animal diseases now established that may be of significance in Canada. (8.66 to 8.100)

The Branch also needs to strengthen certain export certification practices for agricultural and forestry products in accordance with requirements of the international convention (8.101 to 8.110). It also needs to improve support and training for inspectors and relations between line and supervisory staff (8.41 to 8.43, 8.58, 8.82 and 8.83).

DEPARTMENT OF AGRICULTURE
FOOD PRODUCTION AND INSPECTION BRANCH

Overview

8.1 This audit of the Food Production and Inspection Branch of the Department of Agriculture concentrated on the Branch's delivery of its program. The Branch is the government's primary regulatory and inspection arm, in plants registered by Agriculture, for ensuring the quality and safety of the domestic and imported foods Canadians eat (other than fish). Its activities are intended to protect the health and safety of Canadians and Canada's plant and animal resource base and to maintain and improve the marketability of agricultural and forest products. It has developed formal results statements concerning the achievement of these objectives. For example, one of these results statements is to:

> prevent/remove human health and safety threats created through chemical and bacterial hazards associated with food and agricultural products.

8.2 While prevention or removal is the ultimate aim, the Branch can only provide reasonable assurance that it is achieving this intended result. We believe that, for each objective, it can provide such reasonable assurance only by:

- determining which risks are greatest;

- targeting its resources where risks are found to be greatest; and

- setting specific performance targets, in relation to what the Branch is committed to accomplishing.

This theme, of the need to assess risks, allocate a major portion of the resources to the highest risk areas, and operationalize objectives, appears throughout this chapter.

8.3 The Branch's inspection activities have a direct and daily effect on Canadian consumers on the one hand and the agricultural industry on the other hand (see Exhibit 8.1). For example, Canadians on average consume some 95 kg of fresh fruit, 146 kg of fresh vegetables and 71 kg of red meat a year, all of which fall under the Branch's regulatory jurisdiction. In carrying out its mandate to protect human, animal and plant health and safety and to facilitate economic trade within Canada and internationally, the Branch must balance considerations that often conflict.

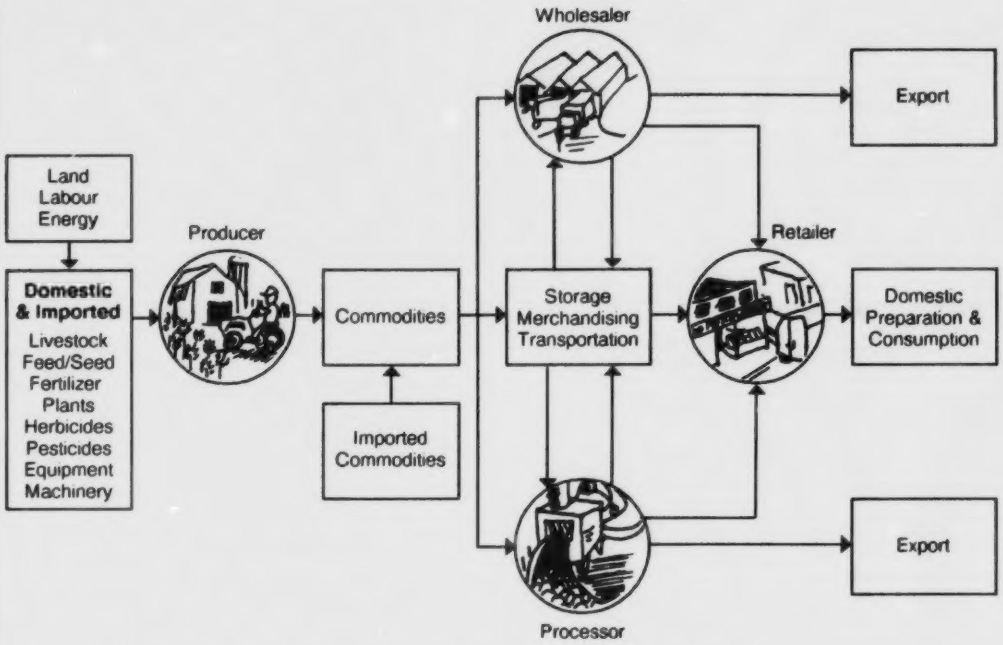
8.4 The Branch reports on its activities in relation to the three inspection programs described below. These represent seven directorates, of which two deliver the programs regionally and five develop policy at headquarters.

8.5 **Food Safety and Inspection**. This includes the Meat Hygiene sub-program for regulating and inspecting meat, and other sub-programs for poultry, fresh and processed fruit and vegetables, and dairy products.

Agriculture inspectors on the job. 1. Poultry inspection in a processing plant. 2. Customs and Agriculture inspection for restricted products. 3. Laboratory analysis of seed samples. 4. Carcass inspection in an abattoir. 5. Air cargo container inspection. 6. Inspection of a ship's hold for insects (see paragraph 8.8).

Exhibit 8.1

THE CANADIAN AGRI-FOOD SYSTEM


Wholesaler
Export
Land
Labour
Energy
Producer
Retailer
Domestic
& Imported
Livestock
Feed/Seed
Fertilizer
Plants
Herbicides
Pesticides
Equipment
Machinery
Commodities
Storage
Merchandising
Transportation
Domestic
Preparation &
Consumption
Imported
Commodities
Export
Processor

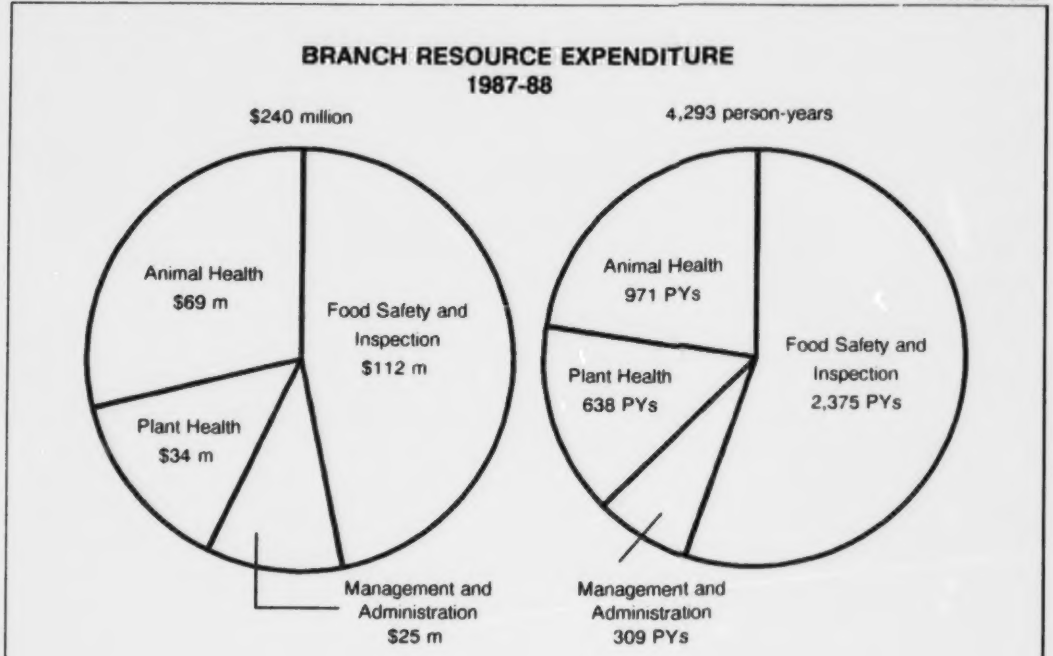
The Food Production and Inspection Branch has an important role to play throughout Canada's agri-food system through its mandate to ensure that food and agricultural products are safe, wholesome, graded for economically significant factors, and packaged and labelled to avoid fraud.

8.6 **Animal Health**. This program has a mandate to regulate and inspect live animals, animal products and by-products such as embryos and animal feeds.

8.7 **Plant Health**. This program's mandate is to regulate and inspect plants, forest products, seeds, pesticides and fertilizers.

8.8 The three programs, and the Branch's management and administration component, require some 4,300 person-years and $240 million, as outlined in Exhibit 8.2. Eighty-five percent of the Branch's personnel are employed in the regions, where inspections at manufacturing plants, airports, and a wide range of other facilities are conducted (see photo).

Exhibit 8.2



Source: Agriculture Canada, 1988-89 Estimates, Part III Expenditure Plan.

8.9 The Branch's legislative authority derives from 10 significant Acts of Parliament and related regulations. It shares responsibility with industry and other provincial and federal departments, such as Health and Welfare and Consumer and Corporate Affairs, that have responsibilities for the safety, health and wholesomeness of agricultural food products.

Audit Scope

8.10 Our audit was limited to the Food Production and Inspection Branch in the Department of Agriculture and concentrated on its program delivery in Food Safety and Inspection, Animal Health and Plant Health – specifically plants, forest products and pesticides. We looked at these programs in relation to the Branch's following five statements of expected results, which it uses as objectives:

- prevent/remove human health and safety threats created through chemical and bacterial hazards associated with food and agricultural products;

- prevent the introduction into Canada of exotic diseases, insects, weeds and other dangerous entities of plant or animal origin;

- control and eradication of exotic diseases, insects, weeds and other dangerous entities of plant or animal origin which gain entry;
- prevent/control/eradicate domestic animal or plant diseases of economic or human health significance; and
- provide the inspection and certification required for export.

8.11 We looked at how the Branch carried out its operations, how it translated the results it expects to achieve into specific targets, and operating procedures' consistency with legislation. In developing our audit findings, we relied on the Branch's internal audits and studies wherever possible.

8.12 The observations and recommendations that follow result from audit examination to March 1988. Departmental responses to our recommendations include corrective actions to August 1988.

Human and Environmental Health and Safety

Chemical and Bacterial Hazards in Food and Agricultural Products

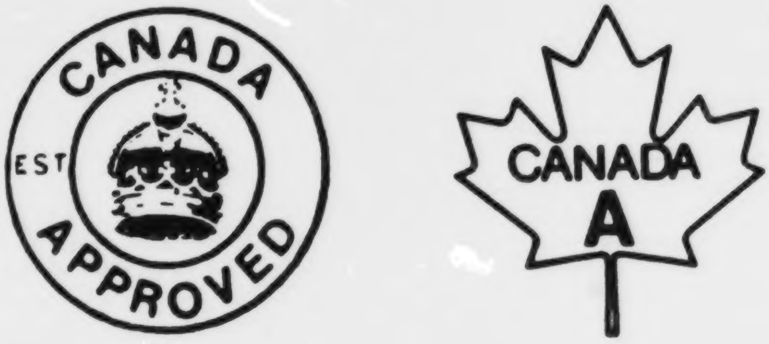
8.13 Industry's goal of safe food is similar to that of the Food Safety and Inspection program. While industry is ultimately responsible for the health, safety and quality of products offered for sale, the Branch is required to inspect and regulate these products according to health standards specified under the Food and Drug Act. The Food Safety and Inspection program's mandate as stated in Part III is to "ensure that food and agricultural products are safe, wholesome, accurately graded (for economically significant factors), packaged and labelled to avoid fraud, thus enhancing their marketability and eliminating human health risks".

8.14 The Branch has an extensive program of inspections of slaughter operations for animals and poultry; monitoring of establishments involved in food production, storage and transportation; grading of livestock carcasses; and monitoring the movement of meats, poultry and dairy products, and fresh and processed fruits and vegetables, to ensure compliance with Canadian and foreign standards for safety, wholesomeness, packaging and labelling (see Exhibit 8.3).

8.15 The program's operations are not only diverse but very significant. In 1987, for example, according to Branch information, it inspected 2.7 million tons of domestic meats, audited and rated the safety of 570 Canadian meat slaughter and processing plants, inspected some 7,500 shipments of imported meats and monitored 1,700 federally licensed produce dealers. It also inspected some 3,000 federally registered establishments for compliance with federal Food Safety Regulations and good food handling practices; conducted health and safety inspections in 160 hatcheries and 350 egg grading stations; and graded 13 million hog carcasses, 2.5 million beef carcasses and a smaller number of veal and lamb carcasses. It should be noted, however, that the Branch has no responsibility for monitoring establishments involved only with intra-provincial trade in agricultural products.

Exhibit 8.3

HEALTH INSPECTION AND GRADE STAMPS



These are examples of the Agriculture Canada stamps that are applied to food products after they have been visually inspected for grading purposes and to determine their "wholesomeness". However, these stamps are not intended to and do not certify that the food product is free of chemical or bacterial contamination.

8.16 In 1987-88, the program used some 2,375 person-years and $112 million, of which the Meat Hygiene sub-program accounted for 1,660 person-years and $80 million.

8.17 In the Food Safety and Inspection program we focussed our audit on activities in support of the Branch's results statement: "to prevent/remove human health and safety threats created through chemical and bacterial hazards associated with food and agricultural products".

8.18 Canadians expect the foods they consume to be not only wholesome but also safe. For instance, public and media attention today turns to the potential risks to human health and safety from chemical residues in foods – such as pesticides, heavy metals, animal growth promotants, antibiotic drugs, feed additives and other substances – as well as the risks from bacteria such as Salmonella and Listeria, and parasitic hazards such as Trichinosis.

8.19 In 1975, the Advisory Committee on Food Safety Assessment, reporting to the Department of National Health and Welfare, found that the Canadian food supply was generally safe. However, the Committee's report also stated that between 1,000 and 2,000 cases of food poisoning were reported annually, and cited evidence that the total number of cases may have been as high as 400,000. Although allocation of responsibility among processors, inspectors, retailers and consumers is difficult to estimate, it is generally assumed that a large portion is due to consumer mishandling of foods.

8.20 Ten years later, in 1985, the Ministerial Task Force on Program Review concluded that consumers' confidence in the safety of foods was justified, and that Canada had an effective food inspection system. It stated that the Branch had taken many initiatives to respond to past challenges in health and safety, disease control and quality assurance. In response to the recommendations of the Ministerial Task Force, the Branch created a National Food Safety Advisory Group in December 1986, representing producers, processors, consumers and federal and provincial government departments. Its purpose is to advise on an appropriate level of food safety inspections, balancing the potential risks to human health and the resources to be devoted to inspections. The Food Safety Advisory Group concluded that "the Meat Hygiene Program is detecting problems and adequately giving assurance that a wholesome meat supply is reaching the Canadian Public."

8.21 Based on our audit findings outlined below, we have concluded that inspection practices need to be strengthened to permit the Branch to provide reasonable assurance that human health and safety threats caused by chemical or bacterial hazards associated with food and agricultural products are identified, prevented and removed.

8.22 **Health risk assessment.** In January 1988, the Advisory Board assessed the risks to human health caused by bacteria, parasites and chemical hazards in domestic and exported meats. It estimated that the annual health and economic costs, such as for medical care, loss of productivity and business, investigation of illness and legal action associated with these hazards range from about $1.1 billion to $1.6 billion. Food poisoning and economic costs caused by Salmonella alone were estimated at $477 million. We are concerned about the threats presented by the most significant of these risks, particularly Salmonella. Its effects have been known for 15 years through studies undertaken and international symposia attended by program managers. Although the Program determined, in 1986, that 51 to 72 percent of broiler chickens tested at the plant level were found to be contaminated by Salmonella, its in-plant inspections have only recently been geared to controlling this. We have been advised that a detailed plan has now been drafted for reducing the level of Salmonella contamination and that its implementation began in late 1987.

8.23 For meat processing, where plants are assessed to determine risk, the Branch does not know whether the plants with higher risks get more rigorous inspections. For example, it conducts national audits of all meat processing plants and establishes ratings ranging from "AAA" to "F". According to the Meat Hygiene Inspection Manual, plants rated "B" and "C" require increased surveillance and monitoring inspections, to correct identified deficiencies. However, because of several operational deficiencies, the Branch does not know whether or not there is an increase in the rigour of inspections for riskier plants.

8.24 For other food commodities, such as dairy products, fresh and processed fruit and vegetables and imported meats, no meaningful risk assessments have been done. As a result, management does not know the extent of human health risks posed by chemical and bacterial contamination in these foods and cannot assure itself that its inspection resources are directed where these risks are greatest.

8.25 The Branch should fully determine the relative risks to human health and safety posed by the chemical and bacterial hazards associated with food and agricultural products. The results of these assessments should be used to direct existing inspection resources to areas of greatest risk.

> ***Management's response:*** *We agree, and the Branch is already acting to determine risk levels and to modify Branch activities. In response to Nielsen, a Quality Assurance and Food Safety Advisory Board was created in 1986. To date, the Advisory Board has completed an assessment of the risks associated with meats. Currently, it is evaluating dairy, red meat grading, poultry and egg products programs. Subsequently, it will assess fruits, vegetables, honey and maple syrup. As well, in April of 1988, the Department created the Agri-Food Safety Division. This organization has assumed the departmental responsibility for risk assessment in food and agricultural products.*

8.26 **Reliance on sensory inspections.** The Food Safety and Inspection program conducts extensive visual and other sensory ante- and post-mortem inspections designed to detect human health risks posed by pathological animal diseases such as tuberculosis, and to find gross contamination. There are also inspections of the meat processing lines according to a detailed Meat Hygiene Manual.

8.27 However, while indicators of health risks from chemical or bacterial contamination in food and agricultural products can be reduced by visual inspection, such risks can generally only be detected and measured by laboratory analysis. Limited laboratory tests are conducted to detect such contamination. For example, the Branch's own documents indicate that residue testing on imported products – largely meats, fruit and vegetables – should be quadrupled. Also, in the Meat Hygiene sub-program, residue and bacterial laboratory testing account for a very small fraction of the budget. A 1986 document issued by Meat Hygiene officials indicates that the budget should be tripled to "ensure the safety of meat products and maintenance of (Canada's) export trade". Without sufficient laboratory testing, food-borne chemical and bacterial contamination could go undetected.

8.28 In the case of surveillance inspections, the carcass is detained until the related laboratory tests are received. However, where meat samples are taken as part of general monitoring, laboratory analysis of them requires anywhere from a few days to a few weeks. The carcass from which the sample was taken is not withheld from distribution pending the results of laboratory testing but leaves the processing plant and is shipped to retailers, regardless of whether the tests later find chemical or bacterial contamination.

8.29 The Branch is aware that several rapid diagnostic tests are available to detect certain chemical residues and bacterial food hazards, and uses a few of these. Such tests can be conducted quickly in the plant by food inspectors, do not require laboratory analysis and can be completed in up to 24 hours. The meat sample could then be traced back to a particular carcass if the results revealed the presence of chemical or bacterial contamination. However, the Branch has not fully assessed the practicality of these rapid diagnostic tests to augment its sensory inspections and current laboratory testing.

8.30 **To meet its stated objectives, the Branch should increase its laboratory testing for chemical residues and bacterial contamination of human health significance in meat and in fruits and vegetables. It should also fully assess the practicality of using rapid diagnostic tests to augment its laboratory testing.**

> ***Management's response:*** *We agree that laboratory testing should continue to increase, and during the last three years chemical and biological residue testing programs in meats have been augmented approximately 20% per annum. Also, through liaison with Health and Welfare Canada, duplication in testing has been eliminated, and efficiency improved.*
>
> *The Branch is fully committed to developing and utilizing practical and rapid diagnostic tests. At present, the Branch has several rapid tests in place. These include the S.T.O.P. (swab test on premises for detection of antibiotic residues), C.A.S.T. (calf antibiotic screening test), and swab tests to determine bacterial loads on equipment. Currently, we are evaluating a commercial diagnostic kit for salmonella, and a card test for detecting sulfa drugs.*

8.31 **Sampling.** In view of the volume of products requiring inspection and laboratory testing to detect chemical and bacterial contamination, food inspectors cannot examine each commodity unit. They must rely on statistical sampling plans to select the units that are to be inspected and sent for laboratory testing.

8.32 The sampling plan used in the Branch is patterned after one developed by the United States Department of Agriculture, and is of the type known as a discovery or exploratory sampling plan. It is used to monitor the incidence of contaminated units of a particular commodity in a population; such as in all hogs or all cattle slaughtered in a particular geographic region over the course of a year. A contaminated unit is one whose level of a particular residue – an animal growth hormone, for example – exceeds a level specified in the Food and Drug Act or the Branch's food safety regulations. The sampling plan is designed to detect, 95 times out of 100, a small but undesirable incidence. This incidence is assumed to reflect the risks to human health posed by specific chemical or bacterial contamination of the particular commodity. The program usually sets the minimum incidence at one percent and this dictates a sample size of some 300 units for each of the five regions. Should one or more sampled units prove contaminated, a surveillance operation may be put into effect, as is the case for certain residues in pork.

8.33 Sampling plans for detecting chemical residues and bacteria have been implemented for domestic slaughtered animals and, to a limited degree, for imported meats. They are used as a basis for a national chemical and antibiotic residue detection plan for meat and poultry of over 10,000 samples annually, and an ongoing meat safety program for parasitic and bacterial organisms of human health significance. The results of laboratory analyses, published annually in summary form, are used to monitor the levels of chemical residues and bacterial contamination across Canada.

8.34 During our audit, we found a number of areas where these sampling plans and their assumptions could be improved:

- The incidence level is not based on a complete assessment of the health risks posed by potential chemical and bacterial hazards and, as such, may not offer sufficient consumer protection against all of these risks.

- The Branch recognizes that any assumption about statistical uniformity within particular food commodities is questionable. However, it asserts that its use of random selection compensates for this weakness. We have considered this but believe that variations in the degree of contamination, for instance in hogs, within a geographic region and over time, are inevitable and will weaken the results of the sampling plans. Shifts below the designated incidence level will have no detrimental effect but those to higher levels could go undetected.

8.35 As a consequence of these weaknesses, the 95 percent confidence that the sampling plans are expected to provide, in detecting human health and safety threats associated with chemical and bacterial hazards in food and agricultural products, is not attained.

8.36 We found that for both domestic and imported fresh and processed fruits and vegetables, worth $3 billion annually, there is very limited testing for chemical residues. Imports are estimated to represent approximately 50 percent of the fruits and 30 percent of the vegetables available in Canada. We have been advised by program officials that sampling plans have now been developed to test for chemical residues in fruits and vegetables in the future.

8.37 Also, the program generally considers that imported meat has been inspected and tested for residues and bacterial contamination in the country of origin, under the "equivalency principle" of import trade. The Branch has not fully evaluated the adequacy of the testing programs of several of Canada's trading partners. Where a particular program appears to be less than adequate, the Branch has not required that it be modified to fulfil minimum Canadian requirements, or has not conducted additional inspections or laboratory testing.

8.38 To avoid bacterial contamination in domestic processed meat products, the Branch relies primarily on good manufacturing practices and draws a sample of only five packages from each lot chosen for testing. The lot is accepted if the organism count in each package is below the maximum level specified. Such a small sample is intended as a deterrent against industry's neglect of good manufacturing practices but it is not designed to, and cannot, distinguish unsafe from safe product.

8.39 We noted the claim in the Advisory Board's report "that there is virtually no risk to consumers associated with the present level of residues". However, our audit noted areas where the sampling plans could be improved, the very limited chemical residue testing in fresh and processed fruit and vegetables, both imported and domestic, and the gaps in testing meat imports.

8.40 **The Branch should complete its evaluations of the adequacy of Canada's trading partners' programs for controlling chemical and bacterial hazards, where**

imported foods are accepted as safe. It should also review its own approach to statistical sampling for residues. In particular, it should:

- **examine the assumption of statistical uniformity within particular food commodities as well as the set incidence levels;**
- **extend revised sampling plans to include detection of chemical residues and bacterial hazards in dairy products, fresh and processed fruits and vegetables and meats, both imported and domestic.**

***Management's response**: The Branch agrees that it should complete its current evaluation of Canada's trading partners' residue control programs. The evaluation of meat products is well under way, the countries which remain to be assessed account for less than 6% of meat imports, and the risk for these last countries is considered to be low. The completion target date for meat products is March, 1989. As well, the Branch has initiated an assessment of the remaining food commodities; completion target date is March 1990.*

By September 1988, the Branch will be reviewing its sampling plans to determine what changes might be required to ensure that the principles of statistical uniformity and incidence levels are respected.

Sampling plans have been implemented for a wide range of chemical residues in imported fruits and vegetables. Sampling plans for bacterial hazards will be completed by the end of January, 1989.

8.41 **Inspector training.** We noted that veterinary technical inspectors are not provided with in-depth training in food sciences, a prerequisite if inspections are to ensure food safety. Under existing legislative authority, veterinarians are responsible for the inspection of meat and meat products. There is a complete and extensive training program to help inspectors detect pathological animal diseases that may pose human health threats, and quality deficiencies, in meats. However, they are not trained to know the dangers to health inherent in some of the substances used in processing or preserving foods, or in appropriate statistical quality control procedures for evaluating the safety of food processing operations.

8.42 We also found a need for improved training in employer-employee relations for the veterinarians responsible for managing meat plant inspections. This is particularly important in view of the large number of grievances lodged by Meat Hygiene inspectors and the management time and effort required to resolve these.

8.43 **Food safety technical inspectors should receive in-depth training in appropriate areas of food sciences and other relevant subjects. Also, veterinarians with management responsibility should receive training in employer-employee relations.**

***Management's response**: We agree with an increased training orientation in food sciences. This shift in training is consistent with the Branch's policy decision to strengthen food safety programs; a direction the Department decided to take in 1986. The Branch has encouraged supervisory staff to take employer-*

employee relations training. By October 1988, the Branch will incorporate into its training policy a plan whereby a veterinary supervisor with five or more employees must receive this training within the first six months of appointment.

8.44 **Medical testing.** In the Food Safety and Inspection program, primary products inspectors carry out a wide range of inspection activities that rely heavily on sensory acuity. Despite this reliance on the senses, inspectors performing this work in one region were not given medical tests for colour blindness or other sensory defects. In the same region we also found that workers in meat plants and other Agriculture inspectors cross-utilized in veterinary inspection roles were not subject to medical testing, even though regulations require that all employees of such plants be free of communicable diseases.

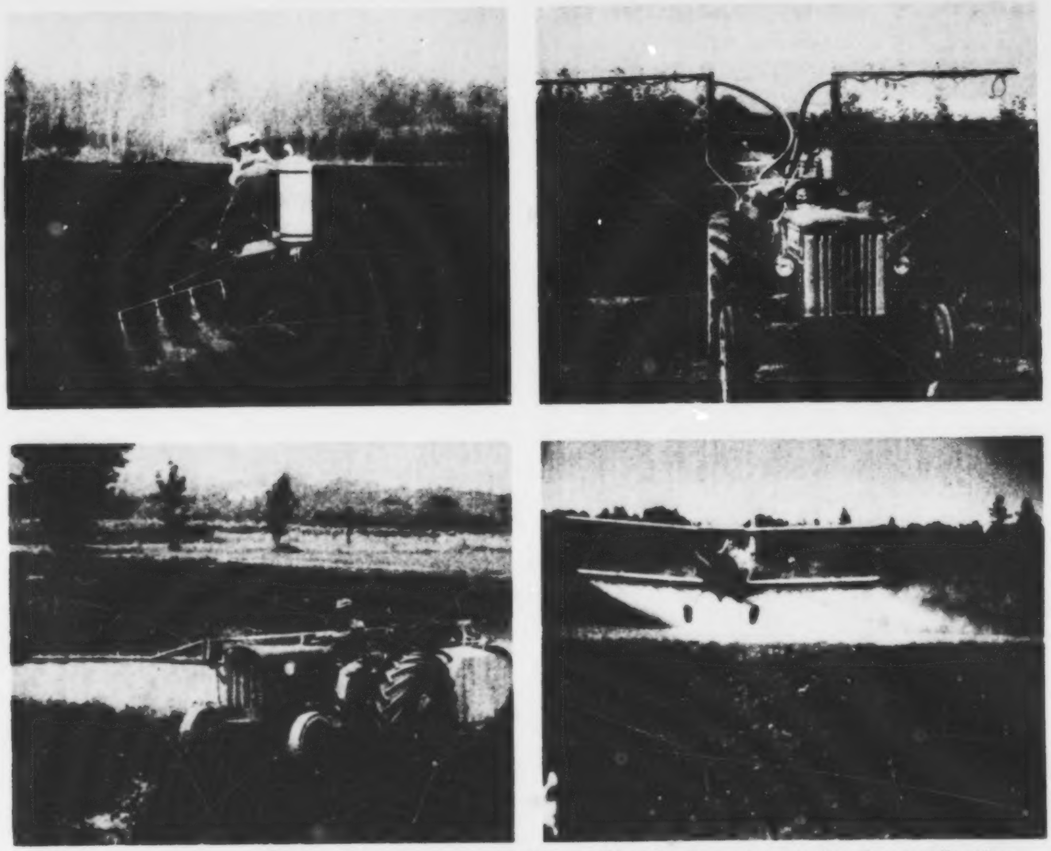
8.45 **Authorities.** Fundamental problems with the Department of National Health and Welfare relating to jurisdictional, legislative, regulatory and inspection concerns have now been resolved. Cabinet has reaffirmed that Health and Welfare has primacy under the Food and Drug Act for defining human health and safety hazards caused by chemical, bacterial and other hazards in food. And it designated the Branch as the primary delivery arm for inspection of all establishments registered by the Department of Agriculture according to food regulations under its jurisdiction.

8.46 Since 1986, an inter-departmental committee has met frequently to address these concerns. In April and May 1988, the two departments signed a memorandum of understanding and several detailed technical appendices. These clarify their mutual responsibilities for ensuring the marketing in Canada of agricultural products which are safe and wholesome, through the enforcement of the Canada Agricultural Products Standards Act and Regulations, the Meat Inspection Act and Regulations, and the Food and Drug Act and Regulations.

8.47 The Branch is in the process of adopting, by reference, all relevant provisions of the Food and Drug Act, such as specifying tolerance levels for chemical, bacterial and other human health and safety hazards in foods, to provide the necessary regulatory base for its inspections. At the conclusion of our audit this had not been completed.

8.48 **The Branch should ensure that its regulations incorporate tolerance levels specified for chemical, bacterial and other human health and safety hazards in food and agricultural products.**

> ***Management's response:*** *The Branch agrees that tolerance levels should be specified for chemical safety hazards in food and agricultural products. The Branch will adopt, by reference, tolerances as they are published by the Department of National Health and Welfare. It is worth noting that on July 7, 1988, an amended Canadian Agricultural Products Act received royal assent. This is a major piece of legislation for food inspection, and its regulations are being updated to incorporate reference to tolerance levels set by Health and Welfare.*



These are various methods of applying pesticides. Like all other chemicals, the application of pesticides requires great care. All pesticide products require registration and regulation under the Pest Control Products Act (see paragraph 8.49).

Pesticide Registration and Regulation

8.49 The Plant Health program includes a Pesticide component which, under the authority of the Pest Control Products (PCP) Act and Regulations, is responsible for the registration and regulation of pesticide products in Canada. In operational terms, the program works to ensure that chemical products for controlling agricultural pests are effective, and pose minimal or no risk to human health and the environment. This program operates in a controversial environment; it must respond to the needs of the farming and chemical industries for effective and timely pest control products and to the health and environmental concerns of the Canadian people (see photo).

8.50 The assessment of pest control products requires co-operation between the Department of Agriculture and other federal departments. The Departments of National Health and Welfare and Environment provide, respectively, advice and recommendations on potential human health hazards from pesticide products and the risk these pose for environmental contamination. Memoranda of understanding have been signed or are being drafted with these departments to help to clarify policy matters. Working level co-ordination has also been established between the Pesticide program and these other departments to facilitate the process.

8.51 However, on the basis of the audit findings outlined below, the Pesticide program needs to strengthen the current procedures for registering and regulating pesticides, to have a basis for providing reasonable assurance that all pesticide products used in Canada are effective and pose minimal or no risk to human health and the environment. Also, many potentially useful pesticide products are not readily available because of delays in registering them.

8.52 **Risk management.** Since 1985, the Pesticide program has moved toward a risk management process where the risks and benefits of pesticides are assessed and the results used to make decisions on new or continued product registration. However, there are no formal guidelines for applying the process, which can lead to inconsistencies in its application.

8.53 **Currently registered products.** We found there is a need to re-evaluate many products, some of which have been registered on the basis of data subsequently found to be invalid. Many were registered prior to 1980 and were not given the same scrutiny that is now required. The federal government may be subject to criticism if it continues the registration of pesticides supported by suspect test data. Also, many currently registered pesticide products have not been fully evaluated for environmental risks. There is no legislative requirement for systematic re-evaluation of registered products, even those where health and safety concerns are high. In practice, pesticide registrations are virtually automatically renewed for a further five years on request and payment of a minimal fee.

8.54 We note that the Pesticide program has recently begun to systematically re-evaluate pesticide products on a limited basis. At the present rate of re-evaluation, however, it will take an estimated 37 to 55 years to complete, and 15 years to review even the highest priority and highest volume products.

8.55 In addition, there are now 150 pesticide products with temporary registrations, normally issued for one year, to permit further product testing. These can also be renewed annually, and the PCP Act does not limit the number of renewals; some products have had temporary registrations for many years. The renewals give the products the same standing as a full registration would, without having to meet the same requirements. In fact, temporary registrations have been issued for pesticide products which were effective in controlling a crop pest but were known to be hazardous to human health. One such pesticide had its temporary registration renewed in 1987 even though management considered its safety studies incomplete and potential human health concerns were evident. The registration was renewed because no alternative control products were available. This is one example of the trade-offs the Branch has to make between economic benefits and human health and safety. Also, the Pesticide program does very limited monitoring to ensure that products are used in compliance with temporary registration conditions – in fact, its work plans do not call for this type of monitoring.

8.56 There is little evidence to show whether pesticide products are manufactured under safe conditions. Although the PCP Act, which has been in force for years, specifically prohibits manufacture of products under unsafe conditions, the Pesticide program has only recently begun to evaluate and inspect the more than 400 pesticide manufacturing facilities in Canada to ensure compliance with the PCP Act and Regulations. These inspections, however, have not provided much information on the safety of manufacturing conditions because they have assessed only laboratory facilities; plant operations have not been reviewed. While inspections of manufacturing plants are desirable, the PCP Act and Regulations do not provide clear and simple authority to support these inspections or to enforce any recommendations for compliance that the Pesticide program might make to the manufacturer.

8.57 The Pesticide program receives approximately 2,000 requests annually for registrations or modifications. We found an accumulation of 3,500 submissions waiting for registration. According to 1987-88 program documents, the registration process for a new active ingredient requires from 12 to 36 months. This appears to result not only from the time required to obtain information when it is needed from other involved departments, but also because of the more intensive and rigorous registration process now being followed. The effect of the delay is to keep pesticide products from being marketed, thus depriving agricultural producers of their use and possibly leading to importation of illegal products. In fact, there is limited import monitoring to determine the extent to which unregistered or illegal pesticide products are being brought into Canada.

8.58 The training provided to Agriculture inspectors who are cross-utilized to monitor pesticides appeared to be inadequate; there is a lack of training plans, and employees learn about pesticides by studying the literature, with no formal instruction. The inspectors themselves feel ill equipped to answer inquiries from industry.

8.59 **Authorities.** We found three gaps in the legislation, two of which have some direct cost implications. First, the PCP Act and Regulations are unclear about who is responsible for the disposal of seized or detained pesticide products. For example, the program detained 560,000 litres of a pesticide product after cancelling its registration. Because this product was still marketed in the United States, the manufacturer voluntarily removed the product. Had this not happened, the Branch might have been liable for the costly disposal of this toxic substance.

8.60 Second, when a product's registration has been cancelled, the PCP Regulations permit a registrant to have the decision reviewed by a Board appointed by the Minister. The total cost of the review is borne by the Crown even though requested by the registrant. A recent review board, for example, cost the Crown some $1 million. As the program undertakes the re-evaluation of registered products, many of which are based on weak information, this costly and time-consuming review procedure may be called for more frequently.

8.61 Finally, there are no operational or special legislative definitions of "safety", "merit", or "value". As these are the conditions under which products are registered, clear definitions of these terms would help in determining the acceptability of a pesticide product and prevent inequities in product registration or cancellation. We understand that these and other regulatory amendments are being actively sought by program officials.

8.62 The Branch should complete its evaluation, as quickly as possible, of currently registered pesticide products on the basis of highest risk and, as a minimum, operational guidelines should be introduced to stipulate the conditions under which this must be done. Also, there should be operational guidelines to limit renewals of temporary registrations, and compliance with registration conditions should be monitored.

> ***Management's response:*** *The Branch agrees that currently registered pesticides be re-evaluated on the basis of highest risk. A systematic process has already been established to determine re-evaluation priorities on the basis of risk-ranking and volume of use. Further, the Branch is exploring alternative delivery mechanisms including a closer liaison with U.S. authorities to investigate opportunities for joint or interchangeable reviews.*
>
> *Consultations have already begun to establish formal operational guidelines for temporary registration. Efforts will continue to carry out selective monitoring, based on volume of use and potential risk, of registration conditions.*

8.63 Manufacturing plant operations should be inspected to assess the safety of manufacturing conditions, and the Act and Regulations should be amended to provide enforcement authority.

> ***Management's response:*** *The Branch agrees that it should pursue its recent initiatives to assess manufacturing operations to ensure product safety. This will be done by monitoring plant laboratory operations. An evaluation of the enforcement authority in the Acts and Regulations will be made.*

8.64 The Branch should take steps to reduce the accumulation of submissions for pesticide product registrations.

> ***Management's response:*** *We agree with the desirability of this recommendation. The Branch will continue to examine the possibility of applying further resources in the registration activity, and will continue to streamline operating procedures and improve efficiency. Finally, we will not introduce shortcuts that will unduly compromise the thoroughness of reviews of human health or environmental quality considerations.*

8.65 The training provided to Agriculture inspectors cross-utilized for pesticide inspections should be improved to address pesticide inspection requirements.

> ***Management's response:*** *We agree, and the Branch has to date provided regional pesticides officers/specialists with "hands-on" technical instructions. Further work will be done in developing and refining procedures manuals and training modules supported by audio-visual material.*

Animal and Plant Disease Prevention and Control

8.66 In addition to human and environmental health and safety, animal and plant disease prevention and control are also important aspects of the Branch's mandate. The Animal Health program is intended to protect and improve the health of Canadian livestock, thereby contributing to the maintenance of markets for Canadian livestock, meat and animal products, and to reducing the transmission of animal diseases to humans. The Plant Health program is intended to control plant diseases and pests.

Preventing the Introduction of Dangerous Foreign Animal and Plant Diseases

8.67 We examined Animal and Plant Health policies and program delivery in relation to the objective stated by the Branch – that is, to prevent the introduction into Canada of exotic (foreign) diseases, insects, weeds and other dangerous entities of plant or animal origin.

8.68 High numbers of air travellers (10 million in 1987) and large volumes of imported agricultural products arrive at hundreds of Canadian airports (see photo), seaports and land ports of entry. The Plant Health program's internal reports indicate that some 513 million plants are imported each year from the United States and 43 million propagative plants from 17 other countries. Also, more than 1 million kilograms of soil and some 72,500 cubic metres of forest products are imported annually.

8.69 We noted the challenges inherent in preventing the introduction into Canada of plant and animal diseases that are prevalent in many parts of the world. Many of these, such as karnal bunt or rust in wheat plants and foot-and-mouth disease in cattle, could be introduced by travellers or through imported commercial products. Canada's plants or forests could become infested with a foreign plant pest carried on imported plants or soil that contained a plant fungus, insect or nematode – a tiny worm-like parasite. Canadian livestock and poultry could contract a foreign disease from live animal imports, or viruses contained in imported meat, dairy or other agricultural commodities. Outbreaks of foreign animal disease, in Canada and elsewhere, have been caused when scraps of meat containing a foreign animal disease virus were fed to domestic livestock. These viruses can be quite durable; for example, research has shown that the foot-and-mouth disease virus can survive in meat for extended periods. If a foreign animal or plant disease were to break out in Canada, the impact on the economy and export trade could be substantial. For example, it is estimated that an outbreak of foot-and-mouth disease in Canada would cost as much as $2.8 billion in reduced farm cash receipts.

8.70 The Plant Health program is responsible for enforcing the Plant Quarantine Act, which requires that all imported plant or other material likely to be infested with a plant pest be accompanied by a Canadian import permit and a health certificate (phytosanitary certificate) from the exporting country. The Animal Health program is responsible for enforcing the Animal Disease and Protection Act that prohibits, restricts or controls the importation of animals and animal products. At ports of entry, Customs and Excise officers act as the first line of defence. On referral from Customs and Excise, Agriculture inspectors monitor travellers and commercial imports for prohibited agricultural products that should be seized or refused entry into Canada. The efficiency and effectiveness of inspection depends in part on the training provided to both Customs and Agriculture inspectors, and on inspection policies and standards.

Garbage compactor at the Lester B. Pearson International Airport used to handle refuse and restricted animal and plant material intercepted by Agriculture Canada from international flights (see paragraph 8.68).

8.71 A number of foreign plant pests with the potential to cause damage have gained entry to Canada and some are spreading, as outlined in Exhibit 8.4. We found that plant and, to a lesser extent, animal products and by-products import inspection practices need to be strengthened to reduce Canada's vulnerability to the introduction of a foreign animal or plant disease.

8.72 **Risk management.** In view of the volume of travellers and agriculture imports arriving in Canada, the size of the border with the United States and the different means of transportation, it is not feasible for the Animal and Plant Health programs to detect all the prohibited products (by regulation or otherwise), that can enter Canada. Risk assessments on a commodity and pest specific basis are needed to determine which imports are of highest risk – that is, most likely to cause disease and significant damage to Canadian plants or animals. Risk is a function of several factors, including the country of origin, the volume imported, and the possible health or economic threats associated with the commodity. After a complete risk assessment, import inspections could be better concentrated on those areas where risks are highest.

8.73 Plant material which may be infected now comes into Canada through as few as 80 and as many as 260 ports of entry. The Plant Quarantine Act and Regulations, however, state that such material shall only be imported through 34 specified ports of entry. This is a further indication of the need for determining the plant material with the highest risk of being

Exhibit 8.4

STATUS OF SOME FOREIGN PLANT PESTS IN CANADA

Pest	Year Reported	Location of Initial Infestation	Current Status
Soybean Cyst Nematode	1987	Ontario	Department determining potential for damage. 1 million acres and $290 million of crop at stake.
Apple Ermine Moth	1981	British Columbia	Established in parts of British Columbia.
European Larch Canker	1980	New Brunswick Nova Scotia	Established and expanding slowly.
Head Smut of Corn	1979	Ontario	Established in 5 provinces.
Tobacco Blue Mould	1979/1948	Ontario	$100 million crop losses in Ontario in 1979. Not known to survive first winter.
Scleroderris Canker of Pine Trees	1978	Quebec	Identified in 6 provinces. Virulent strain expanding in Quebec and Ontario.
European Corn Borer	1978/1920	Alberta/Ontario	Established in 9 provinces.
Verticillium Wilt of Alfalfa	1977	British Columbia	Established in 4 provinces.
European Pine Shoot Moth	1977	British Columbia	Present throughout Canada.
Blackleg of Rapeseed	1975	Saskatchewan	Established in 3 provinces and expanding.
Gypsy Moth	1966	Quebec	Established in 4 provinces. Recent occurrences in British Columbia. In 1985, defoliated 246,342 hectares of Ontario hardwood.
Golden Nematode of Potatoes	1965 1962	Vancouver Island Newfoundland	Control by quarantine zones. Pest present.

A number of foreign plant pests have entered Canada. Plant Health does not always know their impact and has not assessed the costs and benefits of alternative control strategies.

infected so that the Branch can ensure the importation of such material complies with statutory requirements.

8.74 We found that the Plant and Animal Health programs have only considered some risks and have not conducted complete and systematic commodity and pest specific risk assessments. For Animal Health, internal reviews since 1979 have recommended that this be done. Some risk information is obtained from an international organization which disseminates information on animal diseases to member countries. For Plant Health, plant import permit requirements were relaxed in 1976 without a complete examination of the risks involved. The blanket exemption for plant import permits was subsequently cancelled.

8.75 In spite of dedicated inspectors, inspections may fail to detect a considerable amount of prohibited plant and animal products that are brought into Canada. Although inspectors seized 56,000 pounds of prohibited products in 1987 from air travellers alone, Branch studies found that in 1979, only 17.5 percent and in 1983, 36 percent of air travellers carrying prohibited goods were detected at one airport. Since then, air passenger volume has significantly increased, but no follow-up study has been done. For commercial imports, the Branch has not yet assessed the effectiveness of its detection capability. As a result, it does not know what proportion of prohibited products its inspection practices fail to detect or the risk this may pose for introducing foreign plant or animal diseases into Canada.

8.76 Currently, for example, there are limited inspections of rail cars and mail for plant pests; risk assessments would indicate whether this was appropriate. Also, significant plant pest risks may not be adequately addressed, such as those transported on or in seed. An example is a disease called blackleg of rapeseed (canola) that is infecting up to 1.5 million acres each year in Saskatchewan. It caused an estimated yield loss of about 25 percent in 1984 and 12 percent in 1985. We have been advised that the Plant and Animal Health programs have plans to conduct complete commodity and pest specific risk assessments in the near future. Once this has been done, the Animal and Plant Health programs would need to ensure that their import regulations, policies, staff capabilities and inspection practices were sufficient to detect unwanted material in the prime risk areas. Of particular importance is the need for the Plant Health program to improve its scientific diagnostic capabilities – at present, its laboratory resources are very limited.

8.77 In addition to these concerns about meaningful risk management, our audit found that the import practices noted below could cause a risk that foreign animal and plant diseases will be introduced into Canada.

8.78 **Trade facilitation.** In attempting to facilitate trade, Branch actions have permitted the importation of some plant material and animal products and by-products that contravene the Plant Quarantine and Animal Disease and Protection Acts and Regulations, and may also present a potential risk to Canada's plant and animal resource base. For example, the Plant Health program has granted exemptions from plant import permits and health certificates required to certify that the import is free of plant pests. It has also signed compliance agreements with importers which allow plant material to move from a foreign area that may contain a plant pest to a Canadian destination free of that pest if the importer agrees to certain terms and conditions intended to protect the country. However, not only is there no provision for such agreements under the Act, but we also found that the terms and conditions were not adequately monitored and enforced.

8.79 Also, in response to industry requests, the Plant Health program permitted unwashed potatoes to be imported into Ontario from an area it knew was infested with soybean cyst nematode, considered the pest most destructive of soybeans. Ontario is a prime growing area for soybeans. No import permit was required by Canada, and no health certificate from the exporting country. The importers did not carry out the terms of the compliance agreement intended to reduce the risks; for example, the trucks transporting the potatoes were not properly cleaned to destroy the pest. An inspection by Plant Health found nematode cysts in and around the importer's premises. The Plant Health program did not halt the importation because it considered the risks to be low; and it plans to allow the same imports in 1988, but under more rigid compliance terms and conditions to remove the risk of crop infestation.

8.80 Turning to an example in animal products and by-products, Animal Health program policies permit the importation of dairy products, such as soup and sauce mixes, from foot-and-mouth disease affected countries. But, the Regulations require that dairy products be imported from a country free of foot-and-mouth disease, or that the product "has been treated and on inspection is found to be safe". In an effort to minimize the risks of importing these dairy products, the program requires the exporting country to attest that specific heat treatments to inactivate the foot-and-mouth disease virus have been conducted. However, contrary to its Regulations, the program has not determined whether these imported products are actually safe – that is, that the required heat treatment was properly applied and the virus is actually inactivated.

8.81 **Commercial cargo.** Containerized overseas commercial agricultural cargo and settlers' effects are, at the port of entry, loaded onto rail cars and shipped across Canada to inland destinations based on a review of the shipping documents but with limited inspections to determine whether their contents pose any risk of animal or plant disease (see photo). Moreover, according to the Branch's internal audit reports, control over the movement and distribution of such containers for non-meat products at the inland receiving port is also weak. Settler's effects, according to a 1986 Animal Health directive, represent one of the most likely sources of foreign animal disease outbreak.

8.82 **Training of inspectors.** Training is of key importance if inspectors are to recognize significant animal diseases and plant pests and prohibit their introduction into Canada. In our 1982 audit of the Branch, we reported that the training of Plant Health inspectors was weak; five years later, we still found some training weaknesses. For example, import procedures manuals are only in draft form, and Branch officials were finalizing national policies, training modules, and standard accreditation for Plant Health inspectors. We met Plant Health inspectors clearly dedicated to their work who expressed difficulty in coping with the workload, frustration about the gaps in their training, and concern about how to meet the conflicting goals of facilitating trade on the one hand and meeting Canadian import requirements on the other. Plant Health officials have recently renewed efforts to correct the training weaknesses and will shortly be issuing operating manuals.

8.83 **Liaison with Customs officials.** A memorandum of understanding between the Departments of Agriculture and Customs and Excise was signed in 1985, setting out their respective responsibilities. Liaison continues and, in response to the recommendations of the Ministerial Task Force on Program Review, a study is under way to facilitate Customs' referrals to Agriculture. However, we found there were two gaps in the implementation of the memorandum of understanding. First, there are areas where the training Agriculture provides to Customs' officials could be improved. The approach is not consistent across the country; training objectives do not specify what the Customs employee should learn, and the trainee's learning is not assessed. Second, no performance measurement system has been

Overseas cargo in containers is shipped in bond across Canada after a review of the shipping documents but with limited inspection at the initial port of entry (see paragraph 8.81).

implemented to determine Customs' effectiveness in carrying out the functions required by the memorandum.

8.84 **Authorities**. The Branch has found that the Plant Quarantine and the Animal Disease and Protection Acts and Regulations are outdated and require amendments to provide needed authorities for improved import control. These Acts do not provide a sufficient range of sanctions, nor do they provide authority for the Branch's current practice of cross-utilizing plant health inspectors to conduct animal health inspections at ports of entry. While the Branch has recognized these problems, and has proposed amendments for several years to the Acts, they remain in draft stage. Branch officials expect that these amendments will be made in the near future.

8.85 **The Branch should:**

- **conduct commodity and pest specific assessments to fully determine the risks of introducing plant or animal diseases into Canada;**
- **strengthen training and inspection resources in import areas of higher risks;**
- **increase its laboratory testing for plant pests.**

> ***Management's response:*** *We agree that the work which has commenced to assess specific commodity and pest risks should be completed. At present, the Branch's pest risk assessment process is based on international risk assessments combined with the expertise of our professional officers. The Branch will continue its work in this area to complete documentation of risk assessment by commodity and country of origin.*
>
> *We agree, and the Branch will enhance its training program through the preparation of inspection manuals and self-instructional training modules. The manuals will be completed by September 1989, with training modules being produced by September 1990. With respect to inspection, the Branch has provided its import inspectors with a simple information base on Canada's import requirements for plants and plant products. This computerized system is now available on their monitors at the ports of entry and the inspectors have been trained in its application.*
>
> *We agree, and the testing capabilities of the Plant Protection laboratory network are being strengthened by the establishment of additional Plant Health laboratories. The Branch will continue to examine possibilities for application of further resources in this area.*

8.86 **The memorandum of understanding with Customs and Excise should be implemented, including improvement of the training provided by the Department of Agriculture to Customs officials and implementation of a performance measurement system to determine Customs' effectiveness in carrying out the functions outlined in the memorandum.**

> ***Management's response:*** *the Branch agrees that the Memorandum of Understanding with Customs and Excise should be implemented insofar as it relates to improved training and co-operation. The intent of the Memorandum will be further supported by simplifying the demands made on Customs, and by streamlining Agriculture's inspection procedures at ports of entry.*

8.87 **The Branch should discontinue any import practices that do not comply with the Regulations, and the Plant Quarantine and the Animal Disease and Protection Acts and Regulations should be amended on an urgent basis to provide needed authorities.**

> ***Management's response:*** *We agree, and the Branch has drafted amendments to strengthen the Plant Quarantine and Animal Disease and Protection Acts. Further, the Branch will ensure that all plant and animal import practices are in compliance with the Acts and Regulations.*

Preventing, Controlling and Eradicating Plant and Animal Diseases

8.88 Our audit also examined Plant and Animal Health practices with respect to program delivery in relation to the Branch statements of objectives directed at improving the health of Canada's plant and animal resource base. These objectives are:

- control and eradication of exotic diseases, insects, weeds and other dangerous entities of plant or animal origin which gain entry; and
- prevent/control/eradicate domestic animal and plant diseases of economic and human health significance.

8.89 **Plant diseases**. The intent of Plant Health's disease control program is to prevent the spread of a plant pest likely to cause significant damage. Although we noted a few initiatives to control plant pests, we found there was little in the way of program delivery to halt the spread of the many plant pests in Canada, some of which are outlined in Exhibit 8.4.

8.90 For the most part, the Plant Health program only monitors where these diseases are. While foreign pests exist in Canada, the program has a limited process for deciding what to do, or when, where and how to do it. Authorized contingency plans are not in place, and any eradication and control measures are usually taken in co-operation with provincial authorities, and are limited. The Plant Health program has not fully quantified the economic losses caused by plant pests in Canada, as a basis for identifying priorities or developing a national strategy. We found incomplete information about the economic significance of some of these plant diseases as described in Exhibit 8.4. Also, we found that the Plant Health program does little to control the interprovincial movement of plant material in Canada. Also, more could be done to inform industry of regulatory requirements for transporting plant products within and between provinces of Canada.

8.91 We found only a limited integrated pest management strategy at work to control plant pests and diseases within Canada. Such a strategy would combine research priorities and quarantine activities and incorporate various pest control tactics. Through such a strategy it might be possible to encourage greater reliance on biological and cultivation control techniques in combination with the use of pesticides. We believe this limited strategy results, in part, from failure to carry out complete pest risk assessments and lack of co-ordination between the Plant Health and Pesticides programs. Steps have been taken in an effort to improve internal communication.

8.92 **The Branch should co-ordinate its plant pest control functions to ensure that domestic plant disease control programs are focussed on plant pests of highest risk and significance.**

> ***Management's response:*** *We agree with this recommendation, and the Branch is currently reviewing all domestically regulated plant pests for risk and economic significance. Closer co-operation with the provinces in the area of domestic pest control is also being pursued. A national meeting in September 1990, between federal and provincial departments of agriculture to formalize an integrated domestic pest control program is planned.*

8.93 **Animal diseases**. The Animal Disease and Protection Act provides the Animal Health program with extensive powers to prevent, control and eradicate animal diseases. As well, the Branch's stated objective is to prevent, control and eradicate domestic animal diseases of economic and human health significance. The program received international recognition in 1985 for eradicating brucellosis in Canadian cattle and is close to eradicating cattle tuberculosis. Both are serious animal diseases that pose a threat to human health. Also, it has eradicated some foreign animal diseases that gained entry into Canada. However, a recent internal study found that there is no program involvement in most domestic animal diseases considered significant by industry. These include domestic diseases of cattle, swine, poultry, sheep and goats which can affect export trade opportunities and, in two cases, may also affect public health. Livestock losses from animal diseases were estimated by the Science Council in 1985 at $1.2 billion annually.

8.94 To date, the Animal Health program has compiled only limited information on the incidence, epidemiology and related economic losses of significant animal diseases. It is currently piloting a national disease information system which, if implemented as planned, would systematically collect data that could be used to identify priorities for disease control at the national, provincial or producer level.

8.95 We are not suggesting that any one method of controlling animal diseases, such as that used for brucellosis, is necessarily the most appropriate. We would, however, expect the program to document its assessment of the significance of each animal disease of concern in Canada, whether it should or should not be prevented or controlled and, if the prevention or control option is selected, how this could best be achieved. We were advised that no such documentation is available. In light of the Branch's objective, we found differing views in the Branch and among outside experts as to whether there were significant animal diseases that warranted federal intervention. We were further informed that in one view of the Branch the control of domestic animal disease is considered to be primarily a private sector responsibility. If the program is no longer attempting the control of significant domestic animal diseases, it should advise Parliament of this and the reasons, and amend its objectives and resource requirements accordingly.

8.96 **To carry out its stated objective, the Branch should clarify and communicate the direction of the Animal Health program with respect to significant animal diseases in Canada.**

> ***Management's response****: We agree, and the Branch's animal health business statement will be revised and communicated during future consultative meetings on animal diseases.*

8.97 **Animal disease vaccines.** We reviewed the licensing of veterinary biologic products, mainly bacterial and viral vaccines to combat animal diseases. Under the Animal Disease and Protection Act, the Animal Health program has a mandate to ensure that the safety, potency, purity and efficacy of these products is established. However, we found that licenses have been issued and renewed for many products whose efficacy under farm and feedlot conditions has been widely disputed in the scientific literature over many years, notwithstanding that they were tested in a laboratory setting. These disputed products comprise a large proportion of the licensed cattle and pig biologic products. Although the legislation requires annual relicensing, the program does not take the opportunity to require manufacturers to submit additional data to dispel the concerns about product efficacy.

8.98 In 1979, a Branch committee recommended that a laboratory be established to test the safety, potency, purity and efficacy of veterinary biologics and that criteria for field trials be revised. After seven years, a small facility was set up with the expected capacity of one field test a year. Two years later, the first efficacy field trial has yet to begin, although it is now expected in the next two years.

8.99 We also found a long-standing lack of jurisdictional clarity between the Departments of Agriculture and National Health and Welfare over the registration of biologics produced by biotechnology or genetic engineering. New techniques of genetic engineering are expected to result in both large advances and large increases in numbers of vaccines and drugs for animals. Yet the jurisdictional issues between these two departments have remained unresolved for some years. A private company wishing to register its biotechnology products for the Canadian market has had to apply to both departments because of the lack of clarity about who is responsible.

8.100 **The Branch should clarify its policies and develop guidelines to specify the extent to which it will be involved in testing veterinary biologic products under farm and feedlot conditions. It should also work with Health and Welfare to resolve jurisdictional issues for registering biotechnology products.**

> ***Management's response**: We agree, and the Branch will reassess and clarify its policy and guidelines with industry and Health and Welfare at the next consultative meeting on veterinary biologics.*

Inspecting and Certifying Agricultural Exports

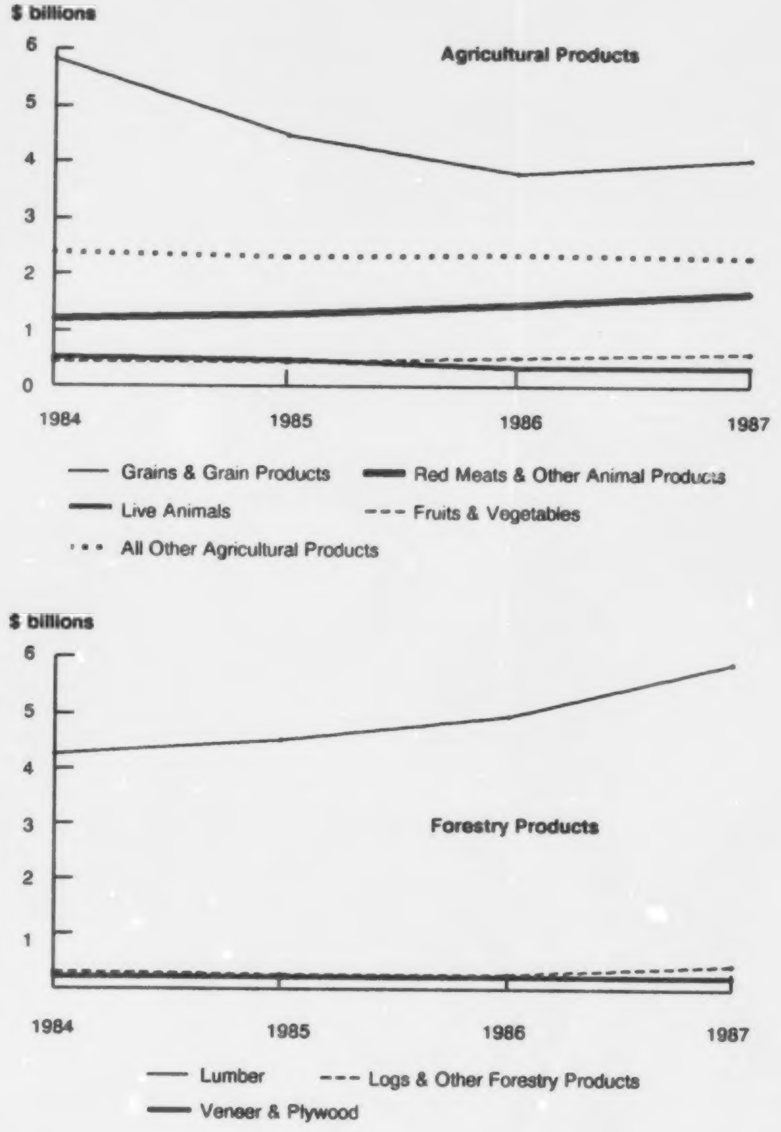
8.101 The Branch's objective in this area is to provide the inspection and certification required for the export of billions of dollars of agricultural, food and forestry products, as outlined in Exhibit 8.5, for conditions specified by the importing country. There appears to be confidence in Canada's export certification system, and new markets have been established. We selected for audit the Branch's export certification process for forest and agricultural products.

8.102 Effective plant pest control cannot be achieved without international co-operation. A high degree of interdependence, where seller protects buyer, underlies the International Plant Protection Convention (IPPC), adopted by the Food and Agriculture Organization of the United Nations in 1951. It replaced a series of international agreements dating back to 1881. Canada played a key role in establishing the first IPPC, which was ratified in 1953.

8.103 The primary objective of the convention is to prevent the spread of plant pests, in part through an international system of phytosanitary (plant health) certification. This requires each government to inspect its agricultural and forestry exports and attest to the absence of plant pests of particular concern to member importing countries. The IPPC was updated in 1979, largely as a result of Canada's initiatives, to cover non-propagative plant material such as grain, which was previously excluded, and to establish a model health certificate. Plant

Exhibit 8.5

AGRICULTURAL AND FORESTRY
EXPORTS SUBJECT TO AGRICULTURE CANADA CERTIFICATION
1984-1987



Source: Information provided by International Programs Branch, Department of Agriculture.

Health inspectors issued some 40,000 certificates in 1987, without which valuable exports of Canadian agricultural and forestry commodities would not have been possible. This is a considerable workload and responsibility.

8.104 We found that, for the most part, the Plant Health program provides the inspection and certification services for agricultural and forest products in accordance with the international convention. Certain practices, however, need to be strengthened to meet the requirements of the convention. The extent of these problems has not yet been fully investigated by the Plant Health program.

8.105 Until a few years ago, trade sampling, where exporters provide samples of their own product to the Plant Health program for inspection, was common in the export of certain commodities. However, it conflicts with the IPPC, since private sector employees are not formally authorized to sample, and there is potential for abuse because the sample cannot be verified. Although the program has reduced its reliance on trade samples, some work remains to be done to eliminate them.

8.106 According to the IPPC, inspections are to be carried out and certificates issued only by or under the authority of qualified and authorized officers. However, we found variations in certification procedures, an absence of comprehensive inspection guidelines, and lack of control over the documents themselves. For example, we noted instances where blank certificates were provided to exporters for completion, with varying degrees of control over their use. Also, some certificates were dated after shipments arrived at their destination or were signed by an unauthorized officer, raising questions of whether inspections were actually carried out. We also noted instances where certificates were altered by third parties after completion and became invalid. Commercial information was sometimes added, quantities changed or special treatments indicated.

8.107 Despite efforts to keep up with information from foreign countries, agriculture inspectors in the field are not always provided with current and concise descriptions of the import requirements of Canada's trading partners. As a result, officers who issue certificates have some difficulty in keeping abreast of what pests are of current quarantine significance to the importing country.

8.108 Although the IPPC intends that plant health certificates be used only as documents from one plant protection service to another, relating to removing biological barriers to trade, certificates are commonly used for purposes unrelated to basic plant health concerns. For example, they are used to satisfy letter of credit requirements or as additional security for shipments. The Plant Health program has not, as yet, developed a complete policy to guide inspectors faced with such commercial uses of phytosanitary certificates. Such a policy would outline an appropriate balance between facilitating trade and preventing the spread of plant pests.

8.109 **The Branch should further develop policies and procedures for issuing phytosanitary certificates and ensure compliance with them. Control over these documents should be strengthened.**

> ***Management's response:*** *We agree, and the Branch's current inspection directive on the issuance of phytosanitary certificates is being updated, and a self-instructional training module is being developed. Finally, an audit program for reviewing phytosanitary certificates issued to client countries is being prepared. All this work will be completed by April 1, 1989.*

8.110 The Branch should improve and implement systems to provide plant health inspectors with current descriptions of the import requirements of Canada's trading partners and guidance in the use of such information.

> ***Management's response:*** *We agree, and the Branch has now completed a comprehensive registry of import requirements for Canada's major trading partners. Inspectors at all ports of entry have been provided with the proper equipment and training necessary to access and interpret this information. Updates to the central computer registry can be made instantaneously.*

Information to Parliament

8.111 Part III of the Estimates offers an opportunity to communicate to Members of Parliament and the public assurance about food quality and safety as well as animal and plant health and disease control. We examined the information provided in Part III of the Estimates and found that it is often ambiguous and inadequate in terms of reporting on the achievement of results.

8.112 The Branch has stated the results it expects to achieve, and approaches for measuring these, in its Operational Plan Framework. However, Part III provides insufficient data on their achievement. For example, in relation to the Branch's objective "to prevent, control and eradicate domestic animal and plant diseases of economic or human health significance", little information is provided to help the reader answer questions such as:

- What is the incidence of domestic animal and plant diseases of concern in Canada? Which are the most significant?
- What has been their impact on the agricultural community, export trade and human health?
- Which diseases is the Branch seeking to prevent, eradicate or control and against what targets?
- What success has been achieved in these areas?

8.113 In fact, because of its objectives, the Branch should but does not have much of this information. For the most part, Part III simply describes the various inspection programs and future plans for them. It does not provide program performance data in relation to intended results on a basis consistent from year to year to facilitate meaningful comparisons or accountability.

8.114 Also, some information provided in Part III is not correct. For example, the 1987-88 document states that "Agriculture Canada has evaluated the testing requirements which would ensure that residue levels in meat, dairy, fruit and vegetable products are within acceptable levels". Again, in 1988-89, Part III states that "residue testing will continue to be a high priority for such commodities as meat, dairy, fruit and vegetables". Our audit found that Branch residue testing procedures are not sufficient to provide reasonable assurance that residues and other chemical or bacterial contamination in domestic food and agricultural products are detected, prevented or removed. Also, we found that very limited residue testing had been undertaken for fruit and vegetables, imported or domestic, in 1987-88 or before.

8.115 The 1987-88 and 1988-89 Part IIIs summarize positive effectiveness results of program evaluation studies, but with no discussion of the studies' limitations. For example, for Meat Hygiene, the 1987-88 Part III states that: "public expenditures on Meat Hygiene activities have generated benefits over the 1970-84 period of $22.5 billion (in 1984 dollars) ... the overall ratio of benefits to costs was 10:3". However, we found the basis of these net benefit calculations was limited to a comparison between no Meat Hygiene program and the status quo. Estimating the nature and magnitude of price changes and production levels in the absence of any program is questionable.

8.116 **In continuing the development of better Part III of the Estimates, the Branch should provide clear data on program achievements in relation to objectives, on a basis consistent from year to year.**

> ***Management's response:*** *The Department agrees with this principle, and is committed to providing accurate, clear and reliable data to Parliament. Future submissions to Part III of the Estimates will be reviewed to ensure that clear relationships to program objectives and consistency with previous reports are demonstrated.*

Agriculture
Canada

Deputy Minister Sous-ministre

Ottawa, Ontario
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SEP 1 1988

LOB 26499

Mr. Kenneth Dye
Office of the Auditor General
240 Sparks Street
7th Floor, West Tower
Ottawa, Ontario
K1A 0C6

Dear Mr. Dye:

This concerns your audit report on our Food Production and Inspection Branch. I wanted to make some general observations to emphasize points made in particular management responses.

The Department appreciated very much your favorable comments on the dedication and high international reputation of the management and inspection staff in the Branch. We have worked very hard to achieve that level of competence and it is encouraging to have it recognized so prominently.

It would probably have been helpful to point out that implementation of the total package of recommendations in the report would require significant increases in resources. Knowledge of this fact is important if we are to make informed judgements on the degree of risk that would be acceptable.

A recurring theme of your report is that resources should be allocated on the basis of risk. We agree entirely. However, the fact that the Branch has already made substantial reallocations to higher risk food safety areas does not seem to have been emphasized. There is also plenty of room for honest differences of opinion in the ranking of various risks.

Agriculture Canada is only one of the components in food inspection in this country. This responsibility is shared with several federal departments including Fisheries and Oceans, Health and Welfare, and Consumer and Corporate Affairs, as well as provincial and municipal jurisdictions. The interdependency of food inspection services could have been more completely addressed by broadening the scope of your audit. This would have allowed you to recognize more fully the accomplishments realized in this difficult environment.

.../2

We would have also appreciated your acknowledging the Branch's shift in emphasis from quality assurance to food safety in its business statements some two years ago. These statements have provided clear, precise messages both to industry and inspection staff.

The Department agrees with you about the direction in which we should be heading. I am simply concerned that the public realize we are farther down the road than your report might lead them to believe.

Thank you for providing me with this opportunity for comment.

Yours sincerely,

Jean-Jacques Noreau

Jean-Jacques Noreau

Deputy Minister
Health and Welfare Canada

Sous-ministre
Santé et Bien-être social Canada

OTTAWA, K1A 0K9

SEP - 9 1988

Your file Votre référence

Our file Notre référence

Mr. Kenneth Dye, F.C.A
Auditor General of Canada
240 Sparks Street
Ottawa, Ontario
K1A 0G6

Dear Mr. Dye:

The Assistant Deputy Minister Food Production and Inspection Branch Agriculture Canada provided the Department with a copy of your draft chapter. Although the mandate is covered in the chapter, upon reading it, I feel that the following brief but concise passage would more clearly define my Department's mandate and role.

The food regulation and inspection system is the responsibility of several federal and provincial agencies.

With respect to food safety, in 1986 the government reaffirmed the absolute primacy of the Minister of National Health and Welfare in all matters affecting health, safety and nutrition. At the same time, the Department of Agriculture was directed to introduce regulatory amendments to adopt by reference under its statues all relevant health and safety regulations under the Food and Drugs Act in order to reduce, and eventually eliminate, any inconsistencies and contradictions in federal regulations. With respect to the regulation of food safety and health in establishments registered by the Department of Agriculture, a "single federal contact department" approach was adopted. National Health and

.../2

Welfare establishes guidelines and standards under the Food and Drugs Act, and carries out inspection audits. Agriculture Canada conducts the ongoing inspections (in non-registered plants Health Protection Branch carries out its own inspection activity). An interdepartmental Committee of Deputy Ministers responsible for food regulation and inspection was also established under the chairmanship of the Deputy Minster of National Health and Welfare to improve coordination and reduce inconsistencies in federal regulatory activities.

These program and policy decisions were taken to maintain and enhance Canada's reputation for excellence in food production.

Yours truly,

Maureen Law

Maureen Law

CANADIAN INTERNATIONAL DEVELOPMENT AGENCY

CANADIAN INTERNATIONAL DEVELOPMENT AGENCY

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9.1 AIDIS Cost Benefit Analyses

9

CANADIAN INTERNATIONAL DEVELOPMENT AGENCY

Main Points

The Canadian International Development Agency (CIDA) is responsible for the largest portion of Canada's expenditures dedicated to helping less-developed countries sustain greater social and economic progress. This year's report focusses on CIDA's contracting, aid information, and Special Programs Branch contributions to non-governmental organizations (paragraphs 9.1 to 9.4.)

Contracts are an essential element in CIDA's delivery of international aid. Work performed under these contracts, however, does not consistently respond to project needs approved by CIDA and the recipient country. (9.16 to 9.34.)

CIDA does not have adequate procedures to ensure that goods are purchased at prevailing market prices or that they have the required Canadian content. (9.35 to 9.42.)

Monitoring of contract implementation is a required part of contract administration. CIDA has procedures to review contractor performance but these need improvement to ensure monitors are in place at the right time and produce the appropriate reports. (9.43 to 9.48.)

CIDA has an Aid Information System to provide financial data and track project implementation. This system which took six years to develop, costing about $40 million, produces adequate financial information but CIDA is not achieving value for money from its project management capability. (9.49 to 9.59.)

CIDA provides funds through the use of contribution agreements to Canadian and international non-governmental organizations involved in international development. Most of these organizations are implementing projects in accordance with their agreements with CIDA. (9.60 to 9.67.)

CIDA's monitoring procedures are not well matched to the nature and types of non-governmental organizations receiving funds from the Special Programs Branch within CIDA. (9.68 to 9.79.)

CANADIAN INTERNATIONAL DEVELOPMENT AGENCY

Background

9.1 The Canadian International Development Agency (CIDA) is responsible for the largest portion of Canada's expenditures dedicated to helping less-developed countries sustain greater social and economic progress. This responsibility is carried out through the International Development Assistance Program (IDA), which provides goods and services, and sometimes funds, to recipient countries in a co-operative effort to assist in their development.

9.2 International development requires CIDA to co-operate with a wide range of partners in Canada and overseas. Consequently, CIDA draws on the expertise of hundreds of Canadian private firms, voluntary organizations and other federal and provincial government agencies, as well as the governments, institutions and voluntary organizations of the developing countries themselves. Through these organizations, CIDA is able to deliver assistance that would be beyond the capacity of the Agency using its human resources alone.

9.3 CIDA's budget of approximately $2.1 billion (1987-88) is divided into Bilateral programs ($957 million); Food Aid ($400 million); Voluntary Organizations ($256 million); Multilateral programs ($152 million); International Development Banks ($146 million); Humanitarian Assistance ($53 million); Industrial Cooperation ($47 million); and Administration ($92 million).

Scope

9.4 In our previous examinations of CIDA's main programs, conducted in 1979 and 1984, we observed a number of system weaknesses in the preparation of contracts to procure goods and services, as well as in the management of information. Monitoring of contributions to voluntary organizations was another area of concern. This report focusses on these issues in greater detail, in addition to reviewing the information provided to Parliament in Part III of the Estimates.

9.5 **Contracting.** CIDA spends approximately $1.1 billion annually to procure goods and services for countries receiving aid. These goods and services include a wide variety of commodities, manufactured products and technical expertise to support specific development objectives. Our audit work entailed a review of the overall contract process, focussing on definition of requirements, statements of work, pricing, Canadian content and contract administration. This review included the examination of 39 contracts totalling $242 million, signed in the period from April 1986 to June 1987, that were randomly selected from CIDA files.

9.6 The 39 items in our sample represent all major types of contracts in which CIDA is involved, with the exception of contribution agreements, intergovernmental agreements and contracts with CIDA co-operants in the field. (Contribution agreements are discussed in our section on Special Programs.) In addition to reviewing CIDA contract files at headquarters, we examined activities for 27 of the contracts at project sites in 10 countries. This field audit work formed the basis for observations that could not have been obtained through file reviews at CIDA headquarters alone. Details gathered from project site audit work, in conjunction with file data, are presented in several case studies illustrating some of the consequences of weaknesses we observed generally throughout the contracting process.

9.7 **Aid Information.** The CIDA Aid Information System (AIDIS) is the electronic record of the Agency's financial and non-financial activities. Our first review of this system was described in the section of our 1984 annual Report dealing with the Comprehensive Agency Management Plan. At that time, CIDA planned that the Aid Information System would be fully operational in October 1984, with enhancements planned for completion in 1987. With these changes now complete, we audited AIDIS to determine how the cost of the system compares with original estimates, the extent to which the cost of development has been controlled and how well the system addresses the financial and non-financial information requirements of the Agency.

9.8 **Special Programs.** CIDA's Special Programs Branch is responsible for encouraging and supporting partnership relations with Canadian-based and international non-governmental organizations. Non-governmental organizations are an increasingly important source of international development expertise. The Financial Administration Act governs CIDA contributions to these organizations and entails certain accountability requirements. We assessed adherence to these accountability requirements in our examination of Special Programs.

9.9 **Information to Parliament.** The purpose of Part III of the Estimates is to provide more and better information to Members of Parliament, thereby permitting them to carry out their review of expenditures more effectively. This information should enable Parliament to gain a basic understanding of each program and assess planned and actual performance in terms of results and resources. In this context, our audit examined the information presented in CIDA's Part III to see whether the document accurately reflected CIDA's program structure and program objectives. We also looked at the style of presentation and the extent to which performance information was provided.

Contracting

9.10 The management of contracting is vital in the delivery of bilateral aid, subsequent to the initiation and approval of specific development projects. Contracting activity is governed by the Financial Administration Act and by government contract regulations; CIDA policy manuals contain detailed information on the process.

9.11 Broadly described, bilateral aid begins with the preparation of a Country Program Review document outlining CIDA's long-term development strategy for the recipient country. From this general strategy, CIDA and the recipient country select a number of projects and Plans of Operation are developed. These projects are implemented through contracts for goods and services that meet the development needs of the recipient country. A project's Plan of Operation may require a number of separate contracts.

9.12 CIDA's Project Team Leaders are responsible for all phases of the contract process and must ensure compliance with CIDA policy and with governmental contract regulations. The contracting process also requires CIDA to respect the role of other government departments involved in Canadian government procurement, in particular the Department of Supply and Services (DSS). Rules governing Canadian government procurement require that DSS purchase goods on behalf of CIDA, but DSS may delegate this authority to CIDA. CIDA has authority to contract for services within approved limits.

9.13 Although CIDA and DSS normally conduct Canadian government international development procurement, authority for procurement is sometimes given to the recipient country. The CIDA Project Team Leader, however, is still responsible for ensuring that contract terms and conditions match Canadian contracting regulations as closely as possible. A CIDA Principal Resource Officer provides technical expertise and advice to the Project Team Leader. Although CIDA sometimes provides in-house resources for contract monitoring, Project Team Leaders often have contracts with Canadian firms to do this work in the field.

9.14 Our audit of the contracting process indicated that CIDA's bilateral manuals and contracting handbooks conformed to the government contracting regulations and the Financial Administration Act. The contracting process is separate from that of bilateral project management, where the needs of the recipient country are identified and agreed on in a Memorandum of Understanding. Our review did not include an examination of CIDA's procedures to identify project needs or to evaluate competing contract proposals, because CIDA keeps only successful proposals on file. CIDA is currently reviewing its policy on records management.

9.15 Our audit focussed on active or completed contracts. Of the 39 contracts we examined, two-thirds contained no significant departure from CIDA contract policies. The remaining contracts revealed weaknesses in requirements definition, statements of work, pricing, Canadian content and contract administration. Concerns similar to ours were raised in recent internal audit work on procurement.

Requirements Definition

9.16 Contracts are an essential element in CIDA's delivery of international aid. Work performed under these contracts, however, does not always respond to project needs approved by CIDA and the recipient country.

9.17 Requirements definition is the first step in the contracting process. The Project Team Leader must interpret the information contained in the project approval documentation and Plan of Operation in order to clearly specify the requirements of the contract. The Project Team Leader must also ensure the contract requirements are consistent with items, elements or components identified in the project approval documentation and Plan of Operation.

9.18 Our review indicated that CIDA practices need improvement to ensure that contracts for the procurement of goods and services consistently match the requirements identified in the project documentation. These requirements are stated in the project Plan of

Operation or Memorandum of Understanding signed by CIDA and the recipient country. CIDA program manuals provide a formal process for reviewing contracts in relation to program priorities and to project approval documentation; however, the process is not consistently followed. Approximately half of the contracts in which we observed deficiencies contained inadequate references to the key project requirements identified in the Memorandum of Understanding and Plan of Operation.

9.19 The omission of key contract provisions pertaining to project requirements has a significant impact on CIDA's ability to hold contractors to account. A contractor is legally required to perform only the work identified in the signed contract. Where all significant project requirements are not included in the contract, CIDA cannot ensure that the work will meet the requirements identified in the project approval documents agreed on by CIDA and the recipient country.

CASE STUDY

Hydroelectric Dam - China

Issue: Requirements Definition

9.20 In August 1986, CIDA signed a $13 million contract with a consortium of Canadian engineering firms and provincial power utilities to conduct a feasibility study on the technical and economic viability of the Three Gorges Hydroelectric Dam project in China. The consortium completed the work in late 1987 and submitted a draft report for approval to the international steering committee's panel of experts in January 1988. At the time of our audit, most of the report had been approved and the Chinese authorities were satisfied with the quality of the work.

9.21 This project, as approved by Treasury Board, had two principal objectives. The first objective was to develop and implement a program of transferring hydro-electric power project technology to the Chinese. The second objective was to produce a feasibility study of the Three Gorges project acceptable to international lending institutions.

9.22 Our audit disclosed that the contract statement of services developed jointly by CIDA and the Chinese authorities addressed only the second objective. Although a significant transfer of technology took place during the feasibility study, the contractor was not charged with the responsibility of developing and carrying out a formal technology transfer program as stated in the project documentation.

9.23 The absence of this objective in the statement of services led to a gap between what the Chinese had expected in terms of technology transfer and what they actually received. Our audit revealed that, while they were satisfied with the feasibility study's results, they did not obtain the understanding they had anticipated with respect to the methodology, principles and procedures used to arrive at the study's conclusions. The contract contained no details on how transfer of technology was to be achieved; for example, in methodology for sedimentation calculations; construction design; environmental impact analysis and resettlement; economic and financial analysis of dam construction, including cost-benefit analysis; design programs for power planning and transmission; and project planning and management.

9.24 Our review also indicated that CIDA does not challenge the need for goods when the Agency is not the prime contributor of funds to a development project. In the project approval process, estimates of the funds required for a project are made at an early stage without full knowledge of all contract or project implications. In some cases, the amounts eventually needed to fulfill project requirements are different than were estimated and approved. This sometimes leads to a re-profiling of the project components. Often, CIDA or the recipient country will identify a new contract requirement within the current project framework. Such newly identified contract requirements should undergo appropriate challenge, but CIDA does not carry out this challenge consistently, particularly when it is not the main contributor of funds to a project. Instead, CIDA relies on the judgement of the other contributors. And in cases where the contract is reviewed by CIDA, there is no assurance it will be done by an officer with sufficient sectoral expertise to understand the contract in relation to overall project objectives.

9.25 It is essential that CIDA review contract requirements when the recipient country is the designated contracting authority. In these cases, CIDA's responsibility is to ensure the contract process does not contravene Canadian government policy or fail to address the contract requirements of the recipient country. The primary purpose in designating the recipient country as the contracting authority is to enable the country to develop expertise in dealing with Canadian suppliers. However, there are no criteria to indicate when this authority is to be granted. Without direct review of the contract requirements, CIDA is unable to know how closely they match the project requirements. This can lead to a situation where funds are used for purposes that match neither CIDA's project authorization nor the recipient country's priorities, resulting in procurement that may be of little benefit to the recipient country.

CASE STUDY

South Sumatra Coal Transport

Issue: Review of Contract Requirements

9.26 The objective of the Indonesian South Sumatra Coal Transport project is to improve the transportation of coal from the Bukit Asam mine to the sea terminal on the coast of Sumatra. Indonesia is the contracting authority. Using parallel financing, 75 percent of the cost of the project is funded by a commercial loan from the Export Development Corporation; CIDA is responsible for providing the remaining 25 percent. CIDA's responsibility for the project, as approved by Treasury Board in 1981, was to provide funds for the purchase of locomotives and a railway communications system. These goods were only one component of a larger Indonesian project which included the refurbishment of rail lines. In 1986, the Indonesian government identified a need for additional steel rails that were to be paid for using CIDA and EDC financing. CIDA subsequently approved the re-profiling of the project to include the purchase of rails. However, because the project is 75 percent financed by EDC through a commercial loan, CIDA did not challenge the need for the quantity of rails to be purchased; nor did it seek the advice of the project monitor in Indonesia. Indonesia then purchased from a Canadian supplier 197 kilometers of steel rails costing $15 million, of which CIDA paid $3.75 million.

9.27 Our audit found that 116 kilometers of this rail, representing $2.2 million of CIDA funds, were not needed for the purposes described in the project documentation. Of these, 66 kilometers will be used to replace rails that do not need to be replaced until 1994. The remaining 50 kilometers are for a maintenance line needing only used rails that were readily available at the site. At the time of our audit, 14 months after delivery and one month before expiry of the supplier's guarantee, approximately 50 kilometers of rail were still unused.

Statement of Work

9.28 A statement of work or description of services in a contract is mandatory when CIDA retains a contractor in the field. It is the responsibility of the Principal Resources Officer to provide a clear statement of work specifying the objectives to be attained and the type and scope of the work to be done. The statement of work must clearly specify the responsibilities of the contractor and other parties to the contract so that questions of interpretation can be avoided. It should provide a description of measurable outputs to which progress and payments can be related, including a schedule for completion of the work. The statement of work should also identify the requirements for approval and acceptance of the work at various stages and at completion.

9.29 Our review indicated that CIDA procedures do not ensure sufficiently precise contract statements of work to provide all parties with a common understanding of what service is to be performed. Because statements of work frequently do not contain sufficient detail on standards of contractor performance, it is difficult for CIDA to assess and record performance information.

CASE STUDY

Canada-Tanzania Wheat Program, Phase III

Issue: Statement of Work

9.30 The purpose of Phase I of the Canada-Tanzania wheat program, which was begun in 1970, was to develop varieties of wheat that would grow well in Tanzania's dry areas, and to supply equipment to two farms. Phase II installed the infrastructure and necessary equipment for five more farms and continued to assist in research. This was described in our 1984 annual Report. Phase III of the project is designed to train the Tanzanians to manage the farms and research programs with less outside assistance and to replace worn equipment as necessary. In April 1987 CIDA signed a contract, termed an "arrangement", with Agriculture Canada, to act as the Canadian executing agent in a $13 million technical assistance program for Phase III.

9.31 In our review of the statement of work in the arrangement, we were unable to find specific details on outputs required of the Canadian executing agent. Instead, the

Canada-Tanzania Wheat Program, Phase III (see paragraphs 9.30 to 9.32)

arrangement identifies a group of activities required to be conducted as part of the administrative responsibilities of the executing agent. Although the arrangement indicates that the Canadian executing agent is to recruit and send a specific number of Canadians with various skills to the farms in Tanzania, there were no details on what results were to be achieved by these people. We had expected the statement of work to identify outputs such as the establishment of applied research programs and training courses in crop management, land use, financial management, equipment and building maintenance, inventory control and plant management.

9.32 A key activity of the arrangement calls for the preparation of an inception plan which would give "more concrete expression to the guidelines in the Plan of Operations", indicating what work would be accomplished to complete the contract. The inception plan was to be prepared mainly by the Project Field Director in Tanzania. Our review indicated that, after one year, the executing agent had not yet sent a field director to the project. Consequently, the inception plan was prepared in the absence of a Phase III Project Field Director as required. Although CIDA personnel visited the project, no technical monitor was hired until ten months after the arrangement was signed with the executing agent. Our view is that the dollar value of this contract is of a magnitude to warrant a clear statement of work in advance of signing the contract, particularly since the arrangement calls for 75 percent of the annual budget of the arrangement to be paid in advance. Without a clear statement of work, it is not possible for CIDA to determine if the work to be done is consistent with the needs of the recipient country that provided the justification for the contract.

9.33 Contract formulation is a highly specialized activity, and lack of clarity has implications for all parties. Without a sufficiently clear statement of work, CIDA cannot enforce the terms of the contract or ensure that the objectives of the project are being fulfilled. For the contractor, lack of precision can lead to work activity that does not match CIDA's expectations or meet the needs of the recipient country. For the recipient country, this can lead to disappointment in the results achieved. Understanding among all parties as to what is to be accomplished is further clouded by CIDA's practice of not disclosing contract terms of reference to the recipient country. Given the number of participants and the complexity of international development work, failure to establish a precise statement of work, or to ensure full disclosure to the recipient, creates the opportunity for misunderstanding, thereby jeopardizing the benefits of CIDA's initiatives and expenditures.

9.34 **CIDA should ensure that all contracts contain clear statements of work that reflect project plans of operation and should obtain agreement with the recipient country on contract obligations and outputs.**

> ***Management response:*** *Agreed. CIDA will ensure that in the future all contract obligations on work to be performed will be disclosed to the recipient country prior to contract signing. However, CIDA would like to indicate that between the plan of operations and the contract drafting stage, projects undergo progressive refinement as the result of a variety of processes including the request for proposals or call for tenders, modifications identified in the selected proposal, and ongoing consultations with the recipient country. As a result of this process, contract requirements and statements of work may not match the plan of operation approved months earlier, but may well reflect recipient needs more effectively. While recipient country agreement on all contract obligations and outputs might prevent misunderstandings this may increase the amount of time required to initiate project implementation.*

Pricing and Canadian Content

9.35 CIDA does not have adequate procedures to ensure that goods are purchased at prevailing market prices or that they have the required Canadian content.

9.36 **Pricing**. To obtain the best price on goods and services, government contract policy states that, where it is cost effective and reasonably efficient, all qualified Canadian firms should have an opportunity to compete for contracts. When competitive bids cannot be obtained, contract regulations require CIDA to document that goods or services were obtained at a fair price in the circumstances. However, CIDA cannot demonstrate that it always receives a fair price because in these non-competitive situations it does not always compare quoted costs to current prices charged by the same suppliers to other purchasers. CIDA requires suppliers to provide a Fair Price Declaration, but it does not regularly monitor the prices of commodities frequently purchased in its aid program. It also does not review the prices obtained through the use of Fair Price Declarations before the contracts are signed, and when it does discover, after delivery, that pricing was not fair, it does not always attempt to recover the difference.

CASE STUDY

Procurement of Potash

Issue: Pricing

9.37 Following CIDA's approval of a procurement request, a recipient country sent a request for bids to a number of Canadian potash producers. On August 25, 1986, three Canadian potash companies informed CIDA of their decision to submit a joint bid. CIDA subsequently requested and received ministerial approval that allowed the recipient country to enter into non-competitive contracts with the supplier consortium. The total value of these contracts amounted to $31.9 million. For each purchase order approved, CIDA obtained a fair price declaration stating:

> The prices quoted are not in excess of the prices currently charged by ourselves to our most favoured customers for similar goods in like quantities under comparable conditions and are considered fair and reasonable.

9.38 During 1987, after completion of these contracts, CIDA performed a price analysis comparing them with the suppliers' other commercial contracts. The analysis showed that a weighted average cost paid by CIDA was $68.54 compared with a weighted average cost of $63.36 (U.S. Funds - FOB Vancouver) for commercial contracts with the same firms for potash sold in the same months as the CIDA purchases. This difference in cost amounts to approximately $1.2 million.

9.39 CIDA conducts audits on firms with whom it has service contracts; these audits are directed primarily toward the analysis of profit margins and overhead rates. No similar audit procedure is applied to contracts for goods where authority to purchase the goods has been delegated to CIDA or the recipient country.

9.40 CIDA should establish audit procedures to ensure the accuracy of fair price declarations.

> ***Management response:*** *Agreed. Although CIDA maintains some commercial pricing information on a few key commodities, it has not conducted formal price reviews on a regular basis. CIDA will establish appropriate audit procedures to ensure the accuracy of fair price declarations.*

9.41 **Canadian content.** The provisions of the Canadian aid program require CIDA to ensure that goods purchased with funds tied to procurement within Canada contain at least two-thirds Canadian content. This provision is particularly important in contracts involving manufactured goods. CIDA's policy is to obtain a written certificate from suppliers attesting to the Canadian material, labour and overhead in goods to be procured. However, CIDA has no procedure to ensure that these certificates are accurate and thus has no assurance it is adhering to this provision of the Canadian aid program.

9.42 CIDA should establish procedures to ensure the accuracy of Canadian content certificates.

> ***Management response:*** *Agreed. CIDA's current policy is that Canadian content certificates are audited at the request of the Project Team Leader only if there is evidence to suggest that further investigation is required or a complaint is received. CIDA will review this policy and implement appropriate procedures to ensure the accuracy of these certificates.*

Contract Administration

9.43 Monitoring of contract implementation is a required part of contract administration. CIDA has procedures to review contract performance but these procedures need improvement to ensure monitors are in place at the right time and produce the appropriate reports.

9.44 CIDA staff's responsibilities in the contracting process focus mainly on front-end activities such as identifying projects, selecting suppliers, negotiating rates and obtaining contract approvals. The Project Team Leader is accountable for the satisfactory completion of the contract, but implementation and monitoring are usually delegated to executing agents or to a CIDA Principal Resource Officer. Because it is not possible for CIDA officers in headquarters to be at all locations where projects are in progress, contract monitors are the expert "eyes and ears" of the Project Team Leader. However, our audit found that contract monitors are sometimes not hired or assigned until after a substantial portion of the contract work has been finished. In other cases, monitors have not been hired until months after the delivery of goods, which the monitor was to have overseen.

9.45 CIDA contracting policy requires periodic reports on the progress of work. These are required to provide salient facts for the reporting period and to signal when 65 percent of the financial limitation of the contract has been reached. However, our audit identified contracts where the executing agents and contract monitors failed to provide the required progress reports. As a result, the Project Team Leader did not have timely assurance that the contractor was meeting all contract obligations.

9.46 CIDA Project Team Leaders are accountable for contractor performance, but they are not always able to use their authority to enforce the terms of the contract. One reason is that contract provisions may not be sufficiently clear on what is to be delivered. Another reason is that the reassignment of personnel within CIDA sometimes creates difficulty in continuity of contract administration and unfamiliarity with contract objectives.

9.47 A decision by the Project Team Leader to enforce contract terms by withholding funds, or by discontinuing the contract, can have a significant impact on diplomatic relations between Canada and the recipient country. Consequently, in the absence of clear contract obligations, the tendency of CIDA officers is to allow the contract to proceed in the hope that problems will disappear without direct intervention. When the Project Team Leader is dissatisfied with contractor performance, CIDA has no internal mechanism whereby contract concerns can be formally discussed to improve contractor performance. CIDA also does not have any means of knowing the degree to which lack of contract clarity impinges on contractor performance.

9.48 CIDA should ensure that contract monitors are in place at the right time to provide adequate support for the ongoing assessment of contractor performance. CIDA should also establish a method to review contract disputes.

> ***Management response:*** *In consultation with Treasury Board and the private sector, CIDA is currently undertaking improvements in its contracting practices to streamline the process so that contractors and monitors reach the field earlier. However, given that contract disputes have arisen in the past which have been successfully resolved by the line management hierarchy with the assistance of legal, professional and technical experts, CIDA sees no requirement to devise additional processes.*

Aid Information

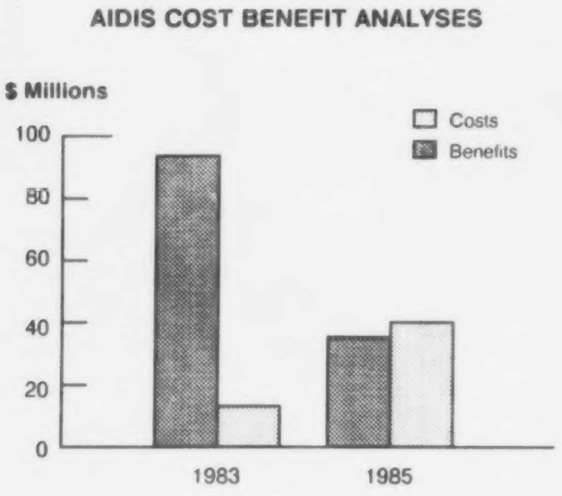
9.49 CIDA has an Aid information System to provide financial data and track project implementation. This system, which took six years to develop and cost about $40 million, produces adequate financial information but CIDA is not achieving value for money from its project management capability.

9.50 The purpose of examining CIDA's Aid Information System (AIDIS) was to review the cost of the system in relation to original estimates, to assess the extent to which the cost of the development had been controlled and to determine if the system is providing CIDA management with essential financial and non-financial information. Our review covered the period from 1979 to 1988.

9.51 The development of CIDA's information system began in 1979 when Phase I - Terms of Reference for a Long Range Systems Plan was drafted. The cornerstone of this plan was AIDIS, which had an estimated development cost of $9.1 million. In March 1980, a Phase II Integrated Systems Overview and Plan for Systems Development was prepared, which included all elements of the previous plan and proposed 49 sub-systems. In November 1982, CIDA awarded a tender for the detailed design of the system. By 1985, AIDIS II was fully operational and has continued to be modified and enhanced.

9.52 Our audit indicated that no cost-benefit analysis had been conducted as part of the original decision to implement AIDIS. The first cost-benefit study of the system was not done until July 1983, after $4 million had been spent. That study projected the benefits of the system to be $94.2 million over a five-year period, against a total development cost of $13.8 million (see Exhibit 9.1). Most of these savings were to be derived from improved procurement, but the study gave little indication of how this would be achieved.

Exhibit 9.1



Graph illustrating CIDA's anticipated benefits and estimated costs of implementing AIDIS.

9.53 An up-dated cost-benefit report issued in September 1985 revised the total quantified benefits to $36.0 million against total costs of $41.0 million (see Exhibit 9.1). This time, much of the savings derived from AIDIS was attributed to the reduction in cost overruns in bilateral development projects. The 1985 cost overruns on all bilateral projects were around $41.9 million; in 1982-83 it had been estimated at as high as $102.7 million. The report attributed about 10 percent of this reduction to AIDIS, with future savings projected at about $19 million, but there was no substantiation of this projection.

9.54 CIDA estimates that development costs for the AIDIS II portion of its information technology systems were $21.8 million as of November 1985. This estimate does not include costs related to user involvement, overhead, training, supplementary development and supporting systems, or costs incurred prior to 1980. We estimate the development costs of the financial and operating management system to be closer to $40 million. Our estimate included overheads such as fringe benefits, accommodation and support; user training time and related costs; the costs of other financial systems developed since 1979; and development costs subsequent to initial implementation in 1985.

9.55 Users of AIDIS view the system as producing accurate, timely and reliable financial information. However, the system is difficult to access, has poor data presentation and in some branches is rarely used by project officers directly. In addition, the system has a limited capacity to aggregate data for reporting and is not very flexible. This lack of flexibility is creating increased costs for developing additional mainframe software and for the extensive use of supplementary microcomputer-based applications.

9.56 Our review of the AIDIS database identified a significant number of project files where non-financial information on project milestones, notes, monthly budgets, field visits, and payment and report schedules was unreliable and consequently unused. These shortcomings, however, do not apply to all branches within CIDA. Some branches have begun to place more emphasis on the integrity and accuracy of their data and are beginning to see the benefits of these efforts. However, given that CIDA is embarking on a decentralization of its operations to the field, it is imperative that the problems encountered in developing AIDIS not be repeated in its field applications.

9.57 Our view is that AIDIS provides accurate and timely financial information similar to that provided by other government financial systems. Its cost, however, is substantially higher than the cost of other government department financial systems. Much of this higher cost is due to the non-financial, project-oriented reporting features built into the system. But because this non-financial information is not extensively used, CIDA is not gaining full value for the money it spent to develop the system. It is senior management's responsibility to ensure the organization's commitment to AIDIS and its ability to deliver quality information.

9.58 In summary, the development of AIDIS has been long and costly. It was undertaken during the formative years of CIDA's data processing organization and, in the early stages of the project, relied heavily on outside contract services without the degree of management control appropriate to its cost. With forecasted benefits imprecise and unsubstantiated, final costs are significantly higher than originally expected. An appropriate costing system was not in place throughout the life of the project, with the result that the true total cost of AIDIS is unknown.

9.59 **CIDA should ensure that the non-financial data entered into the Aid Information System is both accurate and timely.**

> ***Management Response:*** *Agreed. In 1979, the Auditor General noted that CIDA should "... ensure that top priority is given to the completion and implementation of the long range systems plan and the action plans". As a result it was decided to proceed with the design of AIDIS which was the subject of intense discussion and monitoring by the Treasury Board Secretariat and the Office of the Comptroller General. As the report notes, AIDIS provides accurate and timely financial information and there is adequate control over CIDA's program. The AIDIS was designed using hardware and software technology available at the time and therefore is not as flexible as the software now available. Management is aware of the lack of flexibility of AIDIS and is pursuing a strategy leading to a new generation of systems that will build on the investments made in AIDIS, and that will be cheaper and more flexible to operate.*
>
> *Management has noted the Auditor General's observation concerning data entry, and the new generation of systems will ensure that non-financial data are entered into the system on time and accurately.*

Special Programs - CARE Community Water Project - Bolivia (see paragraph 9.61)

Special Programs - HOPE International Irrigation for Community Fodder Project - India (see paragraph 9.61).

Special Programs

9.60 The primary objective of CIDA's Special Programs Branch is to encourage and to support Canadian non-governmental organizations and non-profit institutions involved in Third World development. These organizations carry out their own project planning, delivery, management and liaison activities with development countries, independently of CIDA. In 1987-88, Special Programs spent about 11 percent of CIDA's total international development assistance budget, or approximately $240 million, to support 464 organizations involved in the delivery of more than 4,600 projects in over 100 countries.

9.61 There are five special programs managed by CIDA's Special Programs Branch. Its Non-Governmental Organizations program supports the work of organizations that do much of their own fund-raising. These organizations may be denominational groups, development agencies such as CARE and HOPE International, and associations such as the Rotary Clubs. Most of their work is in small, community-based projects in the areas of education, food production, drinking water supply, public health and income production.

9.62 The Institutional Cooperation and Development Services Program supports organizations that send volunteers abroad (CUSO, for example), co-operatives, universities, colleges, unions and professional associations involved in international aid. These organizations do not have a significant fund-raising capability and receive a large portion of their funds from CIDA. This program is designed to assist the development of human resources and strengthen institutions through the direct participation of Canadian volunteers.

9.63 CIDA also channels international development assistance through its International Non-Governmental Organizations Program. This program gives priority to strengthening organizations that are active largely in assisting rural disadvantaged populations and that encourage the participation of women in the decision-making process. The two other Special Programs are the Management for Change Program and the Public Participation Program.

9.64 Our audit focussed on Non-Governmental Organizations, Institutional Cooperation and Development Services, and International Non-Governmental Organizations. These three programs account for about 93 percent of the Special Programs Branch expenditures.

9.65 Our audit included a review of CIDA's files on 25 organizations selected at random, as well as site visits to 21 projects located in six countries. We did not audit the management of the organizations selected. These organizations were visited to verify information in CIDA's files. We also examined Special Programs management procedures, with particular attention to the monitoring of contributions to voluntary organizations.

9.66 CIDA provides funds through the use of contribution agreements to Canadian and international non-governmental organizations involved in international development. Most of these organizations are implementing projects in accordance with their agreement with CIDA.

Special Programs - CUSO African Tie Dye: Income Generating Project - Sierra Leone (see paragraph 9.62)

9.67 Our review of Special Programs Branch activities indicated that program funding criteria were clearly stated in accordance with government guidelines on financial administration. Furthermore, all organizations in our sample met CIDA's program criteria. In our review of 21 projects in the field, we identified only one that was not performing in accordance with the detailed project description contained in CIDA's files.

Monitoring

9.68 CIDA's monitoring procedures are not well matched to the nature and types of non-governmental organizations receiving funds from the Special Programs Branch within CIDA.

9.69 Government policies on the administration of contributions programs require that program managers put in place appropriate monitoring and control procedures to account for funds expended in relation to the achievement of program objectives. Special Programs' chief methods of monitoring and controlling its contributions are through receipt of periodic program reports from the organizations, project visits by CIDA personnel, analysis of financial statements, organizational assessments and audits.

9.70 **Progress Reports**. CIDA requires recipient organizations to submit periodic reports on their field activities, generally according to an agreed schedule. This enables CIDA, after review, to release funds for payment to the organization. These reports contain information on achievement toward meeting project objectives and project impacts. CIDA usually receives these progress reports as required.

9.71 **Project Visits**. On-site review by CIDA personnel of activities funded by Special Programs is difficult because of the large number of projects, their small size and the number of countries involved. Furthermore, the cost of visiting all project sites would be prohibitive. As a result, CIDA officers cannot visit projects frequently enough or examine them in enough depth to reliably monitor or assess either the organizations or their projects. When officers from CIDA do visit projects, they usually record their key observations, but the Branch does not aggregate key information in these reports for later use in evaluating the Branch programs. We also noted that CIDA officers at Posts have no direct responsibility for monitoring contribution projects operating in their areas. None of the projects we visited had been visited by Post staff.

9.72 **Financial Statements.** Special Programs Branch personnel do not consistently review recipient organizations' financial statements. Although it is Special Programs' policy to conduct this type of analysis and most officers have received some training in financial analysis, we found most files contained no evidence that analyses of financial statements were actually being carried out.

9.73 **Organizational Assessments.** Organizational Assessments are conducted as part of the decision-making process in funding recipient organizations. Because project site visits are not cost-effective, Special Programs uses periodic organizational assessments to review recipient organizations' methods of planning, delivering and monitoring their activities and projects. Organizational assessments focus primarily on the assessment of risk associated with funding specific organizations. These assessments do not always include on-site visits or testing of the organizations' management systems. Twelve organizational assessments were conducted in 1987-88. Our review of a sample of them revealed little information on the organizations' past performance, or tests of their financial, evaluation and audit systems.

9.74 **Effectiveness.** An evaluation of Special Programs Non-Governmental Organizations was carried out in 1984 based on project data gathered between 1979 and 1982. Since then, organizational assessments have been the major outputs of Special Programs evaluation activities. These assessments, however, are not adequate to determine or report on the effectiveness of the Branch programs because they do not contain performance information. Furthermore, evaluation activities are not managed and co-ordinated adequately. The Special Programs Branch evaluation plan, for example, states that:

> The planning for the new evaluations to be undertaken during 1987-88 has not followed any overall SPB strategy but has been left entirely to each individual SPB division as being the best qualified to determine the reasons for which its evaluations will be required.

Evaluation plans are never met in their entirety. There is no evidence that the Branch compares actual performance against the evaluation plans or that it takes action when plans are not met. When evaluations are conducted, their purpose is sometimes unclear to the organizations under review.

9.75 **Audit.** Special Programs Branch policy requires that a sample of organizations be audited each year, but implementation of this policy varies from division to division. The Institutional Co-operation and Development Services division schedules regular audits and conducted six audits in 1987-88, a year in which it provided funds to 123 organizations. In the same year, the Non-Governmental Organizations division provided funds to 152 organizations, three of which it audited.

Project and Program Funding

9.76 Our observations indicate that Special Programs' procedures in the monitoring and control of contributions are inadequate, particularly in the context of recent funding trends. Special Programs Branch currently assists organizations by two major types of funding - project funding and program funding. Project funding entails assistance on a project by project basis. Program funding allows the recipient organization to independently select the projects it wishes to undertake and to manage cash flows among projects on an aggregate basis. Special Programs presently funds 46 organizations on a program basis. In 1986-87, these organizations received about $135 million, or 65 percent of total Special Programs disbursements, and the use of this type of funding is increasing.

9.77 The advantages to the organizations of program funding are security of funds over a period of up to three years, streamlined planning and project implementation, and less paper burden. Organizations funded on a program basis are not required to provide a detailed report on every project; only financial reports and narrative summaries of their field activities are required. From a Special Programs' perspective, program funding is less cumbersome administratively. However, the level of control that Special Programs maintains over the use of program funds is lower than that associated with project funding.

9.78 Contribution programs contain clear obligations to account for funds expended. Grant programs, however, place major emphasis on the decision to allocate funds but not on monitoring their use. Without application of satisfactory accountability procedures, the effect of current funding trends is to change Special Programs from a contribution program to something closer to a grant program. Such a change would require Parliamentary approval of the nature of the program, its objectives, target groups and expected results.

9.79 **CIDA should develop and implement a more systematic approach to account for Special Programs Branch expenditures. This approach should include the application of monitoring and control procedures matched to the nature and types of organizations involved in contribution agreements with CIDA.**

> ***Management response:*** *Agreed. Although we feel there is an adequate system to account for Special Program Branch expenditures we would agree there is room for a more systematic approach. In this regard, CIDA will take steps to improve the aggregation of information from field visits for analytical and evaluative purposes; and integrate audit and evaluation plans in the overall*

organizational assessment process and ensure that these plans are fulfilled. CIDA takes special note of the observation on current funding trends and its accountability implications.

Information to Parliament

9.80 The intention of Part III of the Estimates is to provide information about government programs, details of planned and actual results, related expenditures and other performance data useful in justifying resource requirements. We reviewed Part III of the Estimates for each of the last three fiscal years, for structure, content, style and indicators of performance. The 1987-88 Part III accurately reflects CIDA's program structure and provides more information than in previous years. It would be possible, however, to achieve greater clarity in the graphic illustrations. For example, in the introduction to the 1987-88 Part III, CIDA's aid and development activities are placed within the context of total Canadian overseas development assistance. This provides a helpful illustration of total Canadian assistance, but it is difficult to identify CIDA's direct responsibilities since the graphic display gives the impression that CIDA is responsible for all Canadian official development assistance.

9.81 The use of technical jargon has been reduced, but the Part III is still being written in an overly complex style, making the information difficult to use. This problem is reflected in the views of the Standing Committee on External Affairs and International Trade in its recent report on development assistance policies and programs:

> The estimates that are tabled annually in Parliament are ... virtually impenetrable even to those who compile and use them. There are enough minor discrepancies between the estimates and other versions of planned expenditures as to raise doubts about the whole process. The supplementary explanations of the Main Estimates, known as "Part IIIs", were introduced a number of years ago to shed light on these matters, but they seem to have succumbed to the darkness too. Each year they become thicker and more complex, defeating the very purpose for which they were created.

9.82 Such views are generated by overly complex descriptions of programming and budgeting, as illustrated by the following statement on page 41 of the 1988-89 Part III:

> The deterioration of the economic situation on most countries in the Americas led to the establishment of polysectorial lines of credit in support of structural adjustment programs.

And on page 15 details of the forecast budget are cryptically described:

> In terms of reportable ODA, this amount has been offset by transfers to other ministries and Crown corporations, to be utilized for ODA purposes.

9.83 The Part III also contains information that is difficult to reconcile with information in other sections in the document. Different dollar values for the same budget items are often explained in notes that are unclear and that are placed at locations distant from the text. The text also contains a number of examples of poor editing, the effect of which makes the Part III difficult to follow.

9.84 Part III performance information is not sufficiently related to intentions, previous plans or trends in performance. Sections on resource justification merely contain more detailed descriptions of activities outlined elsewhere in the document. In other cases, incomplete data lead to inaccurate conclusions. For example, Figure 11 in the 1988-89 Part III compares the volume of aid to various regions of the world with the number of person-years allocated to the programs. In most regions, the number of person-years has remained stable or has decreased slightly, while the volume of aid is shown to have increased. This implies that CIDA has been able to accomplish more with the same number of person years.

9.85 This implication is reinforced in Figure 23, which illustrates the growth in International Development Assistance using person-years, current and constant dollars, and number of funded projects and contracts. The explanatory note says, "the Agency's workload has substantially increased in comparison to the person-year base which has remained relatively constant". The dollar amounts accurately portray an increase in spending over the number of person-years, but the number of contracts is more significant. The Figure shows that more assistance work is being carried out by contractors, rather than by CIDA staff. This represents a major change in the organization and delivery of Canadian aid. However, the text contains no discussion on the advantages or disadvantages of the change to contracting, in terms of the effectiveness or efficiency of CIDA's programs.

9.86 The CIDA Part III provides little interpretation of data on program activities. Given the complexity of information, it is essential that this data be placed in the context of expected levels of performance, to enable Parliament to obtain a more complete understanding of future resource allocations, which was the original intent behind the Part IIIs.

9.87 **CIDA should continue to simplify the presentation of information in its Part III of the Estimates by reducing the use of jargon and complex explanations. CIDA also should ensure that its performance data is related to program plans and activities.**

> ***Management Response:*** *The field of international development is vast and complex and it is not always possible entirely to avoid widely used and accepted terminology, on the one hand, and complex explanations on the other. The Agency has improved the presentation of the Part III of the Estimates over the last three years and will continue to improve with the collaboration of the Office of the Comptroller General and the Treasury Board Secretariat. A special effort will be made to present better performance information on our program.*

DEPARTMENT OF ENERGY, MINES AND RESOURCES
THE MANAGEMENT OF FEDERAL-PROVINCIAL CONTRIBUTION PROGRAMS

DEPARTMENT OF ENERGY, MINES AND RESOURCES
THE MANAGEMENT OF FEDERAL-PROVINCIAL CONTRIBUTION PROGRAMS

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DEPARTMENT OF ENERGY, MINES AND RESOURCES
THE MANAGEMENT OF FEDERAL-PROVINCIAL CONTRIBUTION PROGRAMS

Main Points

This year we reviewed three major federal-provincial contribution programs involving a variety of provinces. A contribution imposes a greater degree of accountability to Parliament than, for example, grants or other types of transfer payments. Each program we reviewed showed evidence of weak accountability to Parliament. There are inadequate plans to guide spending on individual projects, and there is very little provision for objective assessment of program results. (paragraphs 10.60 to 10.64)

Some of the projects supported by the $200 million Canada-Nova Scotia Development Fund appear to be appropriately related to the objectives of the Fund, but many others – a total of more than $100 million in project commitments – do not. For example, federal money voted by Parliament to help develop offshore oil and gas resources was used to build unrelated roads, bridges and traffic light systems. Money was also spent, contrary to the terms and conditions of the Agreement, for salaries of regular provincial employees. (10.11 to 10.33)

In contrast, the projects supported by the $225 million Canada-Newfoundland Offshore Development Fund and the $63 million Mineral Development Agreements appear to be related to the broad purposes of these agreements. In the case of the Newfoundland Fund, however, virtually any type of project could be supported if the federal and provincial ministers agreed. Our main concern with the Mineral Development Agreements is that the federal government has not prepared adequate economic development plans on which they could be based. (10.34 to 10.59)

In view of the continuing importance of federal-provincial co-operation in the delivery of many programs, we believe the Treasury Board and program managers should review the problem areas we have highlighted in these programs, and take steps toward improving accountability to Parliament. (10.76, 10.77)

DEPARTMENT OF ENERGY, MINES AND RESOURCES
THE MANAGEMENT OF FEDERAL-PROVINCIAL CONTRIBUTION PROGRAMS

Introduction

Audit Objectives and Scope

10.1 Contributions are one of the means by which Energy, Mines and Resources (EMR) carries out its mandate and delivers its programs. Every year they involve the spending of significant sums. This year, we audited the following federal-provincial contribution programs, which had not been reviewed in detail in previous years:

- the $200 million Canada-Nova Scotia Development Fund. We reviewed the files for all 50 projects approved to date.
- the $225 million Canada-Newfoundland Development Fund. We reviewed the files for all 19 projects approved to date.
- the $63 million of federal funds delivered by the provinces through the Mineral Development Agreements. We reviewed 29 projects in the $44 million contribution agreement with Quebec and the $4 million agreement with British Columbia.

10.2 A contribution, according to the Treasury Board definition, is a "conditional transfer payment for a specified purpose which is subject to being accounted for and audited pursuant to a contribution agreement". Management practices for contributions are contained in the Treasury Board's Guide on Financial Administration, the Comptroller General's Guide on the Audit of Federal Contributions, and in the specific legislation, agreements and terms and conditions approved by the Government for each particular contribution program.

10.3 Our objective was to see if the terms and conditions set out for these contribution agreements had been followed, and if Parliament had been appropriately informed. We did not audit the management of individual projects, which is generally a provincial responsibility. We concentrated on the information made available to the federal government, which is accountable to Parliament for the expenditure of federal funds. Our requests for project justifications, progress reports, and related information from the provinces were channelled through federal officials.

$200 Million Canada-Nova Scotia Development Fund

Description

10.4 The idea of a Canada-Nova Scotia Development Fund was first raised in the early 1980s when there was an expectation that significant offshore oil and gas activity was about to take place around Sable Island. Several problems threatened the development of the offshore, such as the issues of federal-provincial jurisdiction, the sharing of potential oil and gas revenue and the availability of capital for developing the reserves beyond the exploration stage.

10.5 In 1982, the provincial and federal governments resolved these problems and came to an agreement. This was formalized in the 1984 *Canada-Nova Scotia Oil and Gas Agreement Act*. The Act provided for the creation of the Canada-Nova Scotia Development Fund in the amount of $200 million.

10.6 The purpose of the Fund, as stated in the Act, is to finance "infrastructural costs directly or indirectly relating to the exploration for or development, production or transportation of oil or gas in the offshore area" of Nova Scotia.

10.7 The Minister of Energy, Mines and Resources is empowered, subject to approval of the Governor in Council, to enter into an agreement with the Province to establish the criteria and terms and conditions of making payments from and repayments to the Fund.

10.8 In November 1984, the federal and provincial ministers signed the Development Fund Agreement that was approved by the Governor in Council. In accordance with the requirements of the Financial Administration Act, the Treasury Board approved certain terms and conditions governing the operation of the Fund. The following are the main features of this authorities framework:

- Projects to be funded must be for infrastructure costs related to oil and gas activities in the offshore. They must have a defined social and economic rationale; must consider the benefits to Canada and Nova Scotia; must consider the relationship to other provincial and federal initiatives; and must take into account the existing infrastructure. (There is no definition of "infrastructure".)

- Contributions from the Fund are to be repaid by the Province out of revenues from oil and gas royalties.

- There is a $200 million statutory appropriation for the Fund which does not lapse at the end of any particular fiscal year.

- In proposing a project to the federal minister for approval, the provincial minister is to submit a basic description, outline its need, give an estimate of cost and timing and deal with its relationship to the selection criteria.

- Costs of any regular employees of the Province or its agencies are not eligible.

- A joint federal-provincial Development Fund Committee of four persons has been set up. It does not approve projects; its role is to review and monitor their implementation following approval by the federal minister.

- The federal government may make quarterly interim payments based on estimates of costs. The Province must provide a statement of actual expenditures incurred and paid, within three months of the end of the quarter in which the payment was made.

- The provincial auditor is required to certify provincial claims for payment. The Province must produce books and records for audit and inspection on request, and provide access to any project for inspection. In addition, the federal government may commission its own audits of the Fund (and has done so).

- The federal minister is required to table an annual report in Parliament on the operation of the Fund.

10.9 Treasury Board Policy also requires an evaluation procedure for contribution programs, to determine the effectiveness of the contribution in meeting a department's objectives.

10.10 Exhibit 10.1 indicates the current status of the $200 million Fund, which is financed entirely by the federal government.

Observations

10.11 We found that some projects have a reasonable relationship to offshore development. Examples are the shipbuilding and metal fabrication assistance projects, where most of the allotted money has not yet been spent, and support for the decompression chamber at the Victoria General Hospital in Halifax.

10.12 However, we found many other projects financed by federal tax dollars that could be considered questionable in relation to the criteria in the Development Fund Agreement. For example:

- projects that were not related to the objectives of the Fund;

- projects where the costs of regular employees of the province or its agencies were paid, although these were specifically excluded in the approved terms and conditions; and

- failure to co-ordinate federal spending.

10.13 Our observations are summarized below and illustrated by case studies of particular projects. They represent $111 million in committed funds, of which $90 million has been spent.

10.14 **Projects not related to the objectives of the Fund.** Having regard to the importance of offshore development and the substantial funds being provided by various federal departments, we expected a long-term plan to be in place to guide investment decisions and co-ordinate spending. In EMR files we could not find any evidence that there was a strategy or overall plan for infrastructure which would support Nova Scotia offshore development. Although federal officials discussed the idea of having a co-ordinated investment plan for Nova Scotia and Newfoundland, no such plan has been developed to guide the expenditure of funds.

Exhibit 10.1

CANADA-NOVA SCOTIA DEVELOPMENT FUND
SUMMARIZED LIST OF APPROVED PROJECTS TO MARCH 31, 1988
(in thousands of dollars)

Project	Approved	Paid	Balance
Vocational Training Assistance Program (5 projects)	42,411	42,411	
Offshore Resources Development Program (17 projects)	9,331	7,731	1,600
Sheet Harbour Marine Oriented Industrial Park	9,200	9,200	
Sheet Harbour - Stellarton Highway	20,000	4,000	16,000
Woodside Ferry	8,850	8,850	
Woodside Ocean Industrial Park	14,000	9,000	5,000
Shipbuilding and Metal Fabrication Assistance (6 projects)	20,178	5,780	14,398
Trenton Multi-user Wharf Facility	7,200	10	7,190
Trenton Connector Highway	2,615	1,700	915
East Hants - Water and Sewer	2,000	600	1,400
Northside Industrial Park	2,600	1,000	1,600
Land Assembly Services	4,000	4,000	
Pictou Industries Wharf Facilities	5,000	4,000	1,000
St. Martha's Hospital	5,000	5,000	
Sydport Access Road	8,247	6,645	1,602
Sydport Free Trade Zone	2,000		2,000
Highway 125	3,195	3,195	
Highway 107 - Dartmouth By-Pass	14,310	14,310	
North Sydney Industrial Park	1,083	1,083	
Six Projects less than $1 Million each	3,174	1,754	1,420
Shipbuilding and Metal Fabrication (Approved in Principle)	1,822	0	1,822
	186,216	130,269	55,947

10.15 In the absence of an overall plan, we saw ad hoc proposals for spending money on various projects. The individual project descriptions on file were usually brief, and generally they did not appear to us to make a convincing case for spending federal funds. Project proposals did not clearly explain the connection to offshore oil and gas development and other factors listed in the Agreement. Even though the private sector was expected to play a significant role in offshore development, we did not see any analyses of their plans and priorities in relation to the projects being proposed. Nor did the rationale for projects indicate whether or to what extent other federal departments and other levels of government were involved in supporting offshore development.

10.16 Timing for the construction and development of capital infrastructure is important. Roads, bridges and industrial parks must be ready to meet the requirements of a booming offshore industry. At the same time, expenditures made too far in advance of need can be wasteful. Assets can deteriorate, or the situation can change dramatically and make them obsolete.

10.17 Most of the activity in the Nova Scotia offshore has been near Sable Island, where some oil and a considerable quantity of natural gas have been found. The main natural gas discovery is called the Venture Field, located about 177 kilometres southeast of the Strait of Canso or 300 kilometres from Halifax.

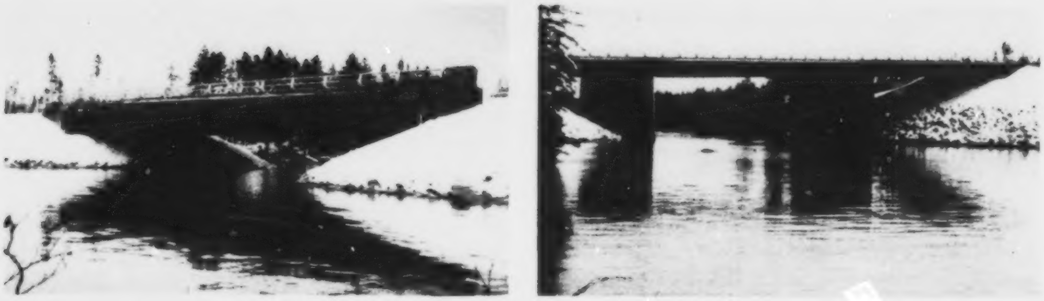
10.18 Between the time the Development Fund Agreement was signed in 1984 and the time when most of the projects were approved in 1985-86, there was a lot of offshore drilling activity, but gas prices were declining and the development of the Venture Field was in doubt. Since the drastic fall in oil prices in early 1986, there has been little oil or gas exploration activity off Nova Scotia and reduced prospects for early development of the known resources.

10.19 The appropriation of money for the Development Fund allowed for uncertainty about when the money would be needed. The full $200 million had been voted by Parliament through statute, to be advanced as required. In light of this, we would have expected funds to be conserved until the need was clearly demonstrated. This did not happen. Despite declining offshore exploration activity and uncertainty as to when it would become economically viable to exploit offshore reserves, spending from the Fund proceeded at a rapid pace. As Exhibit 10.1 shows, between the spring of 1985 and 31 March 1988, $186 million of the $200 million Fund had been committed. Of this, $130 million has already been spent.

10.20 We found the following cases among the projects we looked at.

10.21 **Case 1: Highway 107 and the East and West Petpeswick Bridges**. $14.3 million was spent for the Dartmouth bypass highway, and $2.1 million was spent between 1985 and 1987 to build two bridges which are unrelated to offshore oil and gas development and not yet connected to any road.

- These bridges are meant to link into an eastern extension of Highway 107 from Dartmouth. Another section of this highway, the $14.3 million Dartmouth bypass, was also paid for by the Development Fund. Other parts are being funded through the Canada-Nova Scotia Highways Improvement Agreement administered by the Department of Transport. Transport Canada officials were not informed that the bridges and the Dartmouth bypass were being built using federal funds. Nor did EMR seek information from Transport officials about other related road expenditures before recommending ministerial approval of the bridges.
- At present, the bridges are not connected to Highway 107. It is planned that the missing 8 kilometre stretch of highway will be built by late 1989 or early 1990. Neither the highway nor the bridges appear to have any demonstrable connection with exploration and development of the offshore.



$2.1 million was spent between 1985 and 1987 to build two bridges which are unrelated to offshore oil and gas development and not yet connected to any road.

10.22 **Case 2: Woodside Industrial Park and Ferry.** $9 million has been spent to develop Phase 2 and part of Phase 3 of the Woodside Industrial Park in Dartmouth, notwithstanding the fact that Phase 1 of this park already had significant excess capacity. There is one building in the proposed 127-acre expansion, and no indication of when the rest of the space will be utilized. Nearby, a second ferry service and terminal connecting Halifax and Dartmouth was built at a cost to the Fund of $8.85 million.

- The Woodside Ocean Industries Park is located in Dartmouth. Phase 1 had been developed by 1984 as part of another Canada-Nova Scotia agreement. The Province proposed a 127-acre expansion, to be completed in two phases, to accommodate industries that would service the offshore.

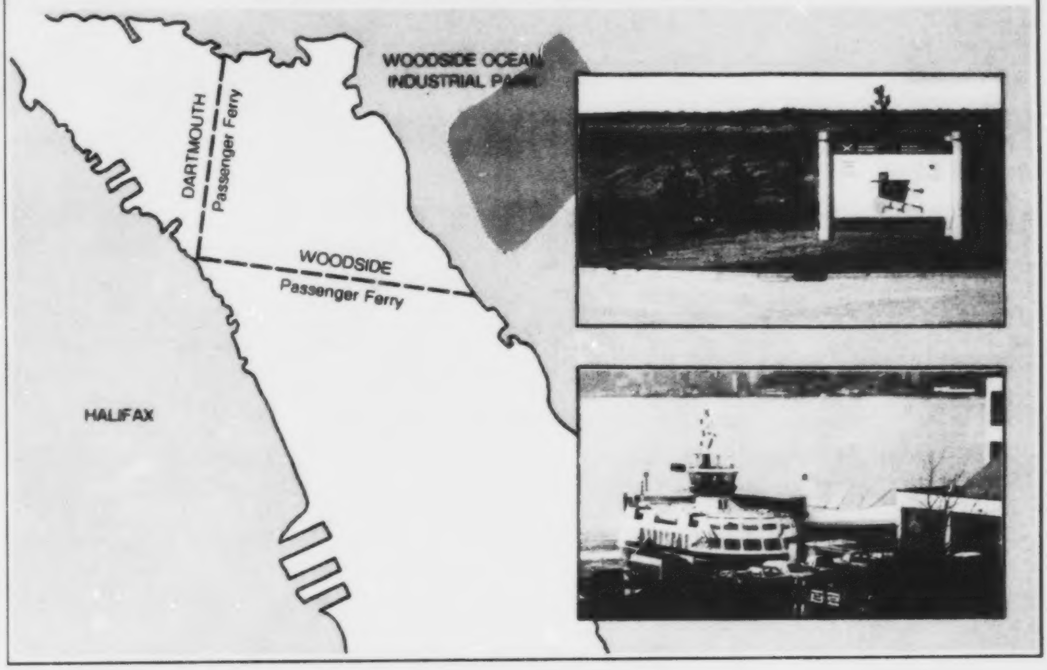
- The project description does not mention any relationship to other industrial park facilities. When the federal Department of Regional Industrial Expansion assessed the proposal in 1984 at EMR's request, it advised deferring Phases 2 and 3 because a three- to five-year supply of serviced industrial land was already available in the Halifax-Dartmouth metropolitan area. Included in this estimate was extra capacity in Phase 1 of Woodside itself. An evaluation of Phase 1, conducted in 1986 for the federal and provincial governments, concluded that "except for the water access portion, the Woodside Ocean Industries Park was not needed. The Halifax Dartmouth area, and for that matter Nova Scotia, already had the capacity to handle the offshore oil and gas activities specifically and the development of the ocean industry sector in Nova Scotia generally."

- At the time of our audit, $9 million of the allocated $14 million had been spent to clear and service Phase 2 and to clear some of the land for Phase 3. Phase 1 was not at capacity and there was one building in Phase 2. We understand a decision has now been taken to suspend further development.

- $2.5 million of the $9 million was a contribution to the South Dartmouth trunk sewer to open up new residential and industrial land. Although presented as a sub-project of Woodside, it has no relationship to the industrial park project.

Exhibit 10.2

WOODSIDE FERRY AND INDUSTRIAL PARK



The sewer system in Phase 1 of Woodside Industrial Park is not connected to the trunk sewer, and no connection points have been installed for proposed Phases 2 and 3 of the Park.

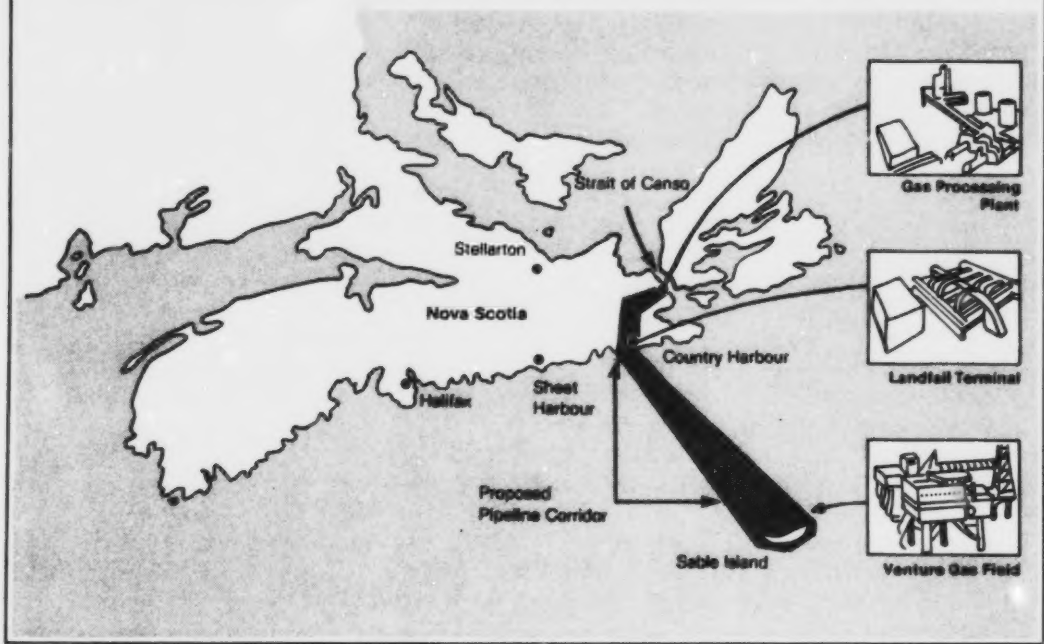
- The Woodside ferry connecting Halifax and Dartmouth uses a common terminal with the existing Halifax-Dartmouth ferry at the Halifax end, and a new terminal that is only three kilometres away from the existing terminal at the Dartmouth end. The new ferry service runs only on weekday rush hours and has gained most of its passengers from the existing Halifax-Dartmouth ferry.

- Although these projects were based partly on an expectation of population growth in the Halifax-Dartmouth area related to oil and gas development, in fact the main Venture project itself was expected to cause an average increase of only 220 persons a year into the area. Overall, we are not convinced there was a valid need to spend the money on these projects at this time for offshore oil and gas development.

10.23 **Case 3: Sheet Harbour Highway and Industrial Park**. $20 million has been committed to a highway from the north shore of Nova Scotia to Sheet Harbour on the eastern shore. The project rationale does not explain how this highway will support offshore oil and gas activity which at present is centred around Sable Island. A $9.2 million industrial park was also built at Sheet Harbour, when there were already underutilized industrial park facilities well suited to serve offshore development at the Strait of Canso and Halifax.

Exhibit 10.3

SHEET HARBOUR IN RELATION TO THE PROPOSED VENTURE GAS PROJECT



- At the time of our audit, $4 million had been spent of the $20 million committed to the construction of a 90 kilometre all-weather two-lane paved highway to connect Sheet Harbour directly to the industrial area in Stellarton-Pictou-Trenton on the north shore. The project description and a press release explained the need for the project on grounds such as speedier travel between Pictou and Sheet Harbour, improved market access for coal mining companies in Pictou County and the possibility of enhanced tourism. Construction was also justified as connecting the infrastructure and services in Pictou County to the development of offshore oil and gas resources. Stellarton is approximately 115 kilometres from Sheet Harbour via existing paved highways. The proposed development plan for the Venture gas project includes a pipeline landfall at Country Harbour on the eastern shore. From there, gas would be transported by pipeline to the Strait of Canso area for processing. The most direct link between Pictou County and Country Harbour or the Strait of Canso is not through Sheet Harbour, but via the Trans Canada Highway.

- Definition of the industrial park project began in early 1985 and went through several revisions before it was approved by the federal minister in late 1985. However, in February 1985 the project had already appeared in the 1985-86 Nova Scotia Estimates, which showed the Development Fund as a source of revenue.

- The project description did not cite any specific connection to offshore oil and gas development. Before the project was approved, federal officials had commented in internal correspondence on the excess capacity at existing facilities at Halifax-Dartmouth and at Mulgrave on the Strait of Canso. They had also noted that the site could not be related to the proposed development plan for the Venture gas field off Sable Island.

- At the time of our audit, the $9.2 million Park was nearing completion, including a new 3.5 kilometre access road. The wharf is being used for the shipment of natural resources such as wood products and gypsum, but there do not appear to be any plans to use the park or the wharf to support the offshore oil and gas industry.

10.24 **Case 4: The Vocational Training Assistance Program**. In response to provincial requests, the federal Minister agreed to set up a special program, the Vocational Training Assistance Program, to cover operational and other expenditures to a maximum of $45 million for two years, 1984-85 and 1985-86.

- An offshore education and training fund had been envisaged in the 1982 Agreement between Canada and Nova Scotia, but it was to be financed by industry and separate from the Development Fund. No separate legislation was introduced, however, and the expenditures were made from the Canada-Nova Scotia Development Fund. This special program was used to fund five projects: $16.2 million for universities, $17.3 million for vocational schools, $5.4 million for institutes of technology, $2 million for computers and software for secondary schools, and $1.5 million for high technology infrastructure.

- For the Vocational Schools project and the Institutes of Technology project, a vague and ambiguous project description form was submitted. This was the key document required to support the approval of the project, and it should have outlined the purpose of the expenditure, how it met the eligibility criteria, schedule and cost estimates, and an implementation plan. The form that was submitted showed the basis on which costs would be estimated, but contained no information about the choice of schools or courses, no explanation of the connection to the offshore, and no schedule or implementation plan.

- We are concerned that part of this money has been spent for purposes not related to the offshore. Vocational school courses such as welding, drafting, cooking, denture technician, photography and stenography were funded. Although some of these had some potential for employment related to offshore oil and gas development, others had less connection.

- The Province requested periodic advance payments, which EMR made. No details of courses were requested by EMR or provided at that time. At the end of this two year special program, the Vocational Schools project was $636,515 under budget, which exactly matches an overrun in the Institutes of Technology project. The project completion reports do not explain the variances. The rest of the course details have now been obtained as a result of audits commissioned by EMR and at our request.

- Based on this additional information, we note that some of the expenditures are contrary to the terms and conditions of the agreement approved by Treasury Board, and that there has been a failure to co-ordinate federal spending.

10.25 **Spending on salaries of employees of the Province or its agencies.** Of the funds provided for the Vocational Training Assistance Program, $22.7 million has been spent on support for technical and vocational training given for the most part by employees of the Province or its agencies. These funds were used in both the Vocational Schools project and the Institutes of Technology project primarily to pay the salaries of staff employed by educational institutions run by the Province. The Development Fund terms and conditions approved by Treasury Board exclude any cost in respect of any regular employee of the Province or its agencies. The Minister's Annual Report to Parliament refers to this project as improving school and university facilities, rather than as paying salaries.

10.26 At the same time as the Vocational Training Assistance Program was set up, the Minister also set up an Offshore Resources Development Program, from which the Fund paid approximately $4 million to various provincial government departments. Some of this money was also spent on salaries and employee benefits for regular provincial employees.

10.27 **Failure to co-ordinate federal spending.** The Vocational Schools and Institutes of Technology projects were aimed at contributing to courses that would train students for employment in the offshore. In essence, the province was to estimate how many students enrolled in existing courses might eventually be employed in the offshore and was to bill the Fund for a corresponding proportion of their costs. Since Employment and Immigration Canada was also contributing to many of the courses involved, there was a requirement to estimate and deduct any payments received from them before submitting the claim to EMR. In such a situation there is a risk of overlapping funding unless eligible expenditures to be paid by each party are clearly defined and properly calculated.

10.28 We were informed that the claims paid by EMR for these projects were based on estimated rather than actual costs. At our request, EMR obtained additional information from the province. When compared with actual costs provided by the province to EMR on June 15, 1988 (some 18 months after the claims had been certified and finalized), it is evident that there were differences between what was claimed and paid for by EMR and the actual expenses incurred in both projects.

10.29 For the Nova Scotia Nautical Institute, for example, after taking into account EIC's share, the information provided to EMR shows "overclaims" of some $663,000 were made to the Fund in 1985-86. Indeed, for that fiscal year the amounts claimed from EIC, EMR and at least one other federal department exceeded the total operating cost of the Nautical Institute. As a result of other discrepancies between claimed and actual expenses, there were "underclaims" in other institutions within the same project. Taken together, the province contends that the "underclaims" balance the "overclaims".

10.30 A complicating factor is that the project description is so vague as to leave open to interpretation the costs to be included. For example, there is no definition of what is to be included in direct cost or overhead despite the fact that EIC was also involved in paying substantial portions of each of these categories of expenses. As a result, neither EMR nor the province had a sound basis for determining how the claims should be calculated.

10.31 In our view, the definition of eligible costs for these two projects, as well as the co-ordination by EMR with EIC and other federal programs, was not adequate to ensure that an overlap of federal funding did not occur. We also believe that for proper control EMR should have obtained a more timely adjustment of estimated to actual costs for these projects.

10.32 **Other cases**. In addition to the four cases cited above, a number of other projects have been approved that are of questionable relevance to offshore oil and gas development. For example, the Fund has committed $2 million for a computerized traffic light control system for Halifax-Dartmouth.

10.33 In total, over $100 million has been committed to projects that are of questionable relevance. These projects deplete the Fund before the long-term infrastructure needs of the Nova Scotia offshore are clear, and set an unfortunate precedent for any future contribution agreements that may be designed to achieve similar purposes.

$225 Million Canada-Newfoundland Offshore Development Fund

Description

10.34 In February 1985, Newfoundland and Canada signed the Atlantic Accord on offshore oil and gas resource management and revenue sharing. The Accord called for a $300 million Development Fund to be set up. Expenditures from the Fund were to be shared 75 percent by the federal government and 25 percent by the provincial government.

10.35 The first payment to the Province was made in October 1987, to cover work in progress. Up to 31 March 1988, $79.1 million in federal funds and $26 million in provincial funds had been committed to 19 approved projects. See Exhibit 10.4 for details. An additional $21 million of federal and provincial dollars has been approved in principle but the funds have not been committed.

10.36 The Act implementing the Atlantic Accord does not define a purpose for the Fund. It merely gives the Minister authority to enter into an agreement. There are no criteria in the Act that might guide the selection or rejection of expenditures.

10.37 Looking to other sources of notice to Parliament of the intent of expenditures from the Fund, one finds the purpose of the Fund stated in the "Grants and Contributions" detail of the 1988-89 Estimates, and it is the same as for Nova Scotia; that is: "in support of infrastructural costs directly or indirectly relating to the exploration for or development, production or transportation of oil and gas in the offshore area".

Exhibit 10.4

CANADA-NEWFOUNDLAND OFFSHORE DEVELOPMENT FUND APPROVED PROJECTS TO MARCH 31, 1988 (in thousands of dollars)

	Federal Funds		
Project	**Approved**	**Paid**	**Balance**
Centre for Earth Resources Research	$ 18,750	$ 3,419	$ 15,331
Offshore Survival Centre	3,750	375	3,375
Skills Training	2,250	46	2,204
Computer Aided Engineering Design Centre	863	863	
Career Development Awards	2,250	724	1,526
Centre for Offshore & Remote Medicine & Telemedicine	2,025	361	1,664
Centre for Cold Ocean Resources Engineering	3,750	1,125	2,625
Centre for Excellence in Marine Signal Processing	5,550	1,766	3,784
Research and Development - Block Funding	3,750	1,125	2,625
Offshore Technology Transfer Program	2,250	260	1,990
Petroleum Technology Training Program	15,825	2,250	13,575
Industrial Infrastructure Planning	975	394	581
Management Training - Marystown	750	750	0
Infrastructure Planning - Marystown	750	375	375
Cow Head Access Road	497	427	70
Administrative Support	375	20	355
Marine Offshore Simulator Training Centre	9,000	75	8,925
Helicopter Flight Simulator Centre	3,150	750	2,400
Segmented Wavemaker	2,625	3,000	(375)
	$ 79,135	$ 18,105	$ 61,030

10.38 The Agreement itself, as approved by the Governor in Council, broadens the purpose of the Fund to the following:

> "...to defray the social and economic infrastructure costs related to the development of oil and gas in the offshore area in the period before production begins and to ensure that the provincial economy is well positioned to reap the economic benefits of offshore development..."

10.39 In addition, the Agreement and terms and conditions allow for funding the salaries of provincial employees and operating costs to training institutions when "...expressly permitted by Ministers...". In all other respects, the project selection criteria in the Newfoundland agreement are similar to those for Nova Scotia.

10.40 As in Nova Scotia, this is a minister-to-minister agreement, but in this case either minister can propose projects to the other for approval. Of the 19 projects approved so far, the $2.6 million commitment to a wave generating project at the National Research Council's Institute for Marine Dynamics is the one that was proposed by the federal minister.

10.41 Also similar to Nova Scotia, there is a Development Fund Committee to monitor and review the implementation of projects following ministerial approval. The Federal Economic Development Co-ordinator in Newfoundland represents the federal aspects of the Agreement and acts as the federal co-chairman. Project management is the responsibility of whichever government proposed the project. The other partner has the right to inspect during implementation.

Observations

10.42 The purpose of the Canada-Newfoundland Offshore Development Fund is not sufficiently detailed in the Act to hold the Government accountable to Parliament for expenditures under it. The purposes of the Fund, as disclosed in the Government's spending estimates, have been broadened by a minister-to-minister agreement without any specific notice to Parliament. Since the terms and conditions for use of the Fund are so broad, virtually any project in Newfoundland would be eligible. As with the Nova Scotia Fund, federal officials are not involved in the preparation and technical analysis of proposals submitted by the Province.

10.43 At the same time, although we are concerned that this agreement is distanced from federal management control and accountability to Parliament, in most cases the types of projects being financed seem to be related to offshore oil and gas development.

10.44 As in Nova Scotia, we saw no sign of a co-ordinated plan for federal investment in the offshore. But an important difference is that in Newfoundland, the Hibernia Benefits Plan and the Hibernia Development Plan have been approved by the Canada-Newfoundland Offshore Petroleum Board. Although these plans do not cover the whole range of offshore activity, they provide a focus for planning, and for dealing with issues of concern such as avoiding the "boom or bust" construction cycle.

10.45 Some projects, such as the enhancements to the Marystown Shipyard, indicate responsible management of Fund monies. In this case, the total expected cost of $19 million has been broken into milestones with funds to be released at stages of progress related to the needs of development of the Hibernia offshore oil discovery. The first milestone is infrastructure planning, to which the federal government has committed $750,000.

10.46 More responsible management of the Fund may perhaps be attributed to several factors, such as the cost-sharing nature of the agreement and the comparatively brighter prospects for oil and gas development in the Newfoundland offshore. The Hibernia plans also provide guidance for the wise use of the Fund. However, since expenditures from the Fund have begun only recently, it is too early to tell if value for money will be received.

10.47 Neither the Newfoundland nor Nova Scotia agreements have built in a requirement for an evaluation. In this respect they differ from many other federal-provincial agreements, including the mineral development agreements. This does not excuse the federal government from carrying out its own evaluations, as required by the Treasury Board. We are therefore concerned that there are no plans for conducting effectiveness evaluations of the expenditures.

Exhibit 10.5

DISTRIBUTION OF FEDERAL MDA FUNDS TO MARCH 31, 1988 *
(in millions of dollars)

	Fed. & Prov. Funds	Total Federal Funds	Direct Federal Delivery	Federal Contribution
Newfoundland	$ 22.0	$ 15.4	$ 11.6	$ 3.8
Nova Scotia	26.9	16.1	14.1	2.0
New Brunswick	22.3	15.0	13.1	1.9
Prince Edward Island	0.3	0.2	-	0.2
Quebec	100.0	50.0	6.8	43.2
Ontario	30.0	15.0	11.0	4.0
Manitoba	24.7	14.8	14.8	-
Saskatchewan	6.4	3.2	3.2	-
British Columbia	10.0	5.0	0.6	4.4
Yukon **	3.9	3.5	2.2	1.3
Northwest Territories **	7.0	4.9	2.9	2.0
	$ 253.5	$ 143.1	$ 80.3	$ 62.8

* No agreement has been signed with Alberta up to this point in time.
** Responsibility of Indian Affairs under Economic Development Agreements.

$63 Million Mineral Development Agreements

Description

10.48 The federal government is providing $143.1 million to selected provinces under a series of Mineral Development Agreements (MDAs), each of which runs for five years. The partners to the agreements match this in aggregate with $110.4 million, making the cost-shared total for MDAs $253.5 million. Of the federal government's $143.1 million, $62.8 million is delivered through federal-provincial contribution agreements. The distribution of money is shown in Exhibit 10.5.

10.49 Although the stated purpose of each MDA varies, the common purpose could be represented as follows:

- to establish frameworks for the implementation of programs and measures to stimulate mineral development and increase economic benefits of the mining industry in a co-operative and co-ordinated manner.

10.50 The MDAs are funded through the Resources and Technical Surveys Act and managed on behalf of EMR by the Mineral Policy Sector. Each MDA specifies how the federal and provincial governments will co-operate in individual and joint activities. A federal-provincial management committee has overall responsibility to ensure that the intent as well as the terms and conditions of the agreement are met. Working level technical sub-committees usually recommend annual work plans to the management committee for approval.

10.51 Our audit focussed on the $43.2 million of federal funds in Quebec and the $4.4 million of federal funds in British Columbia that are delivered through contribution agreements. In the Quebec MDA, each partner has agreed to spend $50 million. The federal government is providing $5 million directly to various programs related to asbestos, and $1.8 million in techno-economic studies. The remaining $43.2 million in federal funds is contributed to the Province to deliver the following programs:

Geoscientific Activities	$ 17,375,000
Mineral Development Infrastructure	13,453,700
Opening up the Iron Ore Industry	6,996,300
Public Relations	125,000
Promotion of Mining Sector	2,000,000
Mining Exploration Assistance	3,250,000

10.52 In the British Columbia MDA, each partner has agreed to pay $5 million. The federal government is providing approximately $625,000 directly, in the form of geological surveys. The remaining $4,375,000 is contributed to the Province to deliver the following programs:

Promotion of B.C. Mineral Potential	
- Geological Surveys	$ 2,827,000
- Geoscientific Data Systems	195,000
- Market, Feasibility and Technical Studies	583,000
Financial Assistance for Mine Development	523,000
Management, Public Information and Evaluation	247,000

10.53 The Quebec and British Columbia mineral development agreements come under the umbrella structure known as Economic and Regional Development Agreements (ERDAs). The ERDA objectives are: to emphasize a strategic approach to regionally focussed programs, based on coherent national policies and analyses of economic strengths of sectors and regions; to contribute to regional development by providing critical infrastructure; to ensure that assistance provided to the private sector will be for activities that are self-sustaining in the long term; and to ensure that activities of each level of government are clearly identifiable by Canadian taxpayers. The government-wide responsibility for ERDAs was assigned to the Minister of State for Economic and Regional Development (MSERD). In mid-1984, this responsibility was transferred to the Minister of Regional Industrial Expansion.

10.54 According to the Government Organization Act of 1983 and subsequent legislation, an ERDA agreement with a province was to be preceded by a plan for economic development approved by the MSERD minister or his successor, in concert with other ministers. We have found no indication of what these plans should contain, but we think they should provide a rationale for how much money should be allocated to particular industry sectors, such as mining, forestry, fishing or tourism. This would allow MDAs to fit within the economic plan agreed to through the ERDA agreement with the province.

Observations

10.55 Mineral development agreements differ from the development funds in a number of ways. MDAs involve less money within any one province, and the money is voted annually by Parliament. The agreements are also more detailed than those for the development funds. For example, they define the management structure in more detail; they state the share of the cost to be paid by each participant; and they describe the mineral development programs and the financial resources allocated to each program, for each of the five years during which the agreement is in force.

10.56 As with the development funds, however, we have some concerns about whether Parliament, or the Government, is in a position to know whether the MDA programs or projects are achieving their overall purpose. We could find no evidence that adequate economic development plans were prepared to provide a framework for the MDAs. The Quebec and British Columbia ERDAs do not provide a clear mineral development strategy at the provincial level, to build on areas of strength, for example, or to support weak industries.

10.57 Within this uncertain framework, EMR proposed programs that would benefit the minerals sector within each province, for discussion with its provincial counterparts and final approval by Cabinet. However, the logic supporting the selection of programs was not clearly documented. For example, $7 million was provided toward a highway to open up the Quebec iron ore industry, at a time when world prices were falling and the Canadian industry had excess capacity.

10.58 The lack of precision regarding economic development plans and objectives for MDAs has created problems in evaluating their effectiveness. The departmental assessment and our own review showed that little useful evaluation has been done. EMR does not have plans to evaluate the overall $143 million MDA expenditure in relation to departmental objectives. It is planned that all individual agreements will be subjected to final evaluation. Some interim evaluation work of varying quality has been done for most of the agreements except Quebec.

10.59 Once the projects have been approved, the process for implementing them seems to work reasonably well. However, we found some problems in the management of the Quebec Agreement. For example, the management committee has not met as often as required; EMR has had some problems in obtaining progress reports; and at the time of our audit EMR had audited only the first year of the Agreement, 1985-86.

Conclusion

10.60 The federal-provincial agreements we audited shared one characteristic: weak accountability to Parliament. We examined the course of events to see whether and to what extent Parliament could hold the Government accountable for the results of money spent.

10.61 There are several ways federal money can be transferred to the provinces - for example in the form of grants, contributions, or other types of transfer payments. In the cases we examined, the method chosen was to set up contribution agreements, with terms and conditions approved by Treasury Board Ministers. This imposes a requirement for the Government to control funds and to account to Parliament for their results.

10.62 Because these contribution agreements were conducted on the basis of partnership with provincial governments, a major factor determining their success would seem to be the degree of understanding that exists between the two levels of government. From the federal point of view, for example, problems could arise if a provincial government attempted to pursue objectives that did not coincide with the stated purpose for which the federal Parliament had voted funds.

10.63 For the MDAs and the Newfoundland Development Fund, we were generally satisfied that the projects being implemented were consistent with the governing legislation. But in the case of Nova Scotia, federal money voted by Parliament to help develop offshore oil and gas resources was used to build unrelated roads, bridges and traffic light systems. Often, the federal Minister's approval of Nova Scotia projects seems to have been given in light of an interpretation of the Agreement that was different from the legislated purpose as passed in an Act of Parliament.

10.64 In all of the agreements we found instances where they did not comply with the accountability requirements for contribution programs set by the Treasury Board - for example, regarding evaluation of effectiveness.

10.65 We reviewed the problem areas we found in the various agreements to see if there were any useful lessons that could be drawn for the future, and our conclusions follow.

10.66 **Clear objectives.** The process of government accountability to Parliament for expenditures should begin with clearly stated objectives. If the Government's strategic planning assumptions or logic are weak, Parliament should have the opportunity to challenge them in an effort to clarify objectives. This process did not seem to be working well in the federal-provincial agreements we audited. Many questions, such as the following, were not asked:

- How were the dollar values set?
- How would initiatives relate to other government programs?
- What would be an appropriate pace of spending to match need while avoiding a "boom and bust" cycle?, and
- What type of projects are excluded from funding?

10.67 For the Nova Scotia and Newfoundland Development Funds, strategic planning appears to have been a process of negotiation between elected governments. The output of this process has been a package deal which is presented to Parliament. Debate on the package and the opportunity to adjust it are limited, because a small change could cause the whole deal to collapse.

10.68 In the case of the MDAs, objectives are set by ministers after negotiations by officials, but again the process takes place beyond the view of Parliament. The legislative base for the ERDAs is the Government Organization Act, while the funding for the MDAs is through the Resources and Technical Surveys Act. Parliament is not involved in questioning or clarifying the economic objectives of ERDAs to form plausible links with the mineral objectives of the MDAs. Again, package deals are negotiated with another government. Parliament's chance to influence them comes only through the annual appropriations process.

10.69 **Role of the Treasury Board.** Normally when legislation is debated by Parliament, vague and open-ended clauses can be questioned, and perhaps clarified. This did not happen with the legislation enacting the development funds. The "offshore infrastructure" purpose of the Nova Scotia Development Fund is broad and unclear as to what is excluded. The Newfoundland Accord Act does not specify a purpose for the Development Fund at all; instead, the Minister was empowered to negotiate and sign a Development Fund Agreement once it was approved by the Governor in Council. This process places the onus on central agencies like the Treasury Board Secretariat to specify what is intended so it can be successfully implemented.

10.70 The Treasury Board does not seem to have played a strong control role during the process of creating terms and conditions for the development funds, to ensure that the broad wishes of Parliament were defined in operational detail. In neither of these agreements, nor in their terms and conditions, did the Board clearly define "infrastructure", flesh out the broad selection criteria, insist on a formal analysis by federal officials of economic viability, social factors, and relationship to objectives or include a requirement for evaluation. Where appropriate, most of these points are covered in the MDA contribution agreements.

10.71 We suggest that the Treasury Board and its Secretariat should play a leadership role in interpreting the intent of Parliament so it can be carried out.

10.72 In addition, both before and after agreements are signed, there is a need for better co-ordination between federal departments, to present a consistent image to the province and to prevent overlapping programs. The administration of the Nova Scotia Development Fund needs to be strengthened in this regard. Treasury Board or other central agencies could play a useful role here in ensuring that this co-ordination takes place.

10.73 **Evaluation.** Strategic plans and objectives may be difficult to state even though there may be a legislative requirement for them. This weakness in accountability could be balanced in part by a strong feedback mechanism, such as program evaluation. But evaluation, as applied in these agreements, may not be an effective accountability tool. In the development funds there are no plans for evaluation, while in the MDAs interim evaluation efforts so far have not produced useful results. In our view, the Treasury Board should have ensured that appropriate evaluation procedures were in place before authority to spend funds was granted.

10.74 **Better Definition of Need.** Where there are clear and pressing needs which provide a focus for spending decisions, there would seem to be a closer relationship between stated objectives and the use of funds. This appears to be the case in Newfoundland. Where needs and objectives are not clearly defined, some braking mechanism needs to be installed to ensure that money is still available when the requirements come into sharper focus. Annual appropriations provide one means of keeping control.

10.75 **Cost Sharing.** The Nova Scotia fund is financed 100 percent by federal dollars. In Newfoundland, the province must contribute 25 percent. We also note that, a portion of the work is always cost shared in the MDAs. The experience with the Newfoundland Fund and the MDAs indicates that cost-sharing in federal-provincial agreements is an incentive for each partner to seek cost effectiveness.

10.76 **Recommendation.** Because our audit covered several federal-provincial agreements within only one department, we cannot draw government-wide conclusions. Nevertheless, it appears to us that there is a need to ensure, at a minimum, that all legislation presented to Parliament is consistent with the best control practices already developed in the Government. Moreover, the special nature of federal-provincial contribution arrangements may require special measures to improve accountability to Parliament.

10.77 **The Treasury Board and program managers should review the problem areas we have highlighted, and apply the lessons learned to future federal-provincial contribution arrangements. The following factors appear to be particularly important:**

- **definition of clear objectives;**
- **more specific definition of needs and plans in terms and conditions;**
- **independent program evaluation;**
- **cost sharing; and**
- **adequate interdepartmental co-ordination of federal spending in a province.**

DEPARTMENT OF FINANCE
MANAGEMENT OF THE BORROWING PROGRAM

DEPARTMENT OF FINANCE
MANAGEMENT OF THE BORROWING PROGRAM

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11

DEPARTMENT OF FINANCE
MANAGEMENT OF THE BORROWING PROGRAM

Main Points

Gross public debt has climbed from under $40 billion at the start of the 1970s to over $325 billion today. Interest on the public debt has become the largest expenditure of the federal government. (paragraphs 11.1, 11.2)

Borrowing to meet the federal government's financial requirements is affected by environmental considerations such as volatile and unusually high real interest rates, less regulated financial markets and competitive financial institutions. To the credit of the managers of the borrowing program, these requirements have been met and an ongoing commitment to cost reduction is evident. (11.22, 11.23 and 11.55)

Development of a least-cost strategy, or base case, should be seriously considered for use as a yardstick against which the benefits and costs of alternative strategies could be evaluated. This approach would require that secondary objectives, opportunities, constraints, and risks associated with borrowing activities be clearly specified. It would also provide an important first step in evaluating the effectiveness of the borrowing program. (11.41 to 11.54)

The full relative costs of different debt instruments - savings bonds, marketable bonds and treasury bills - should be taken into account when setting the proportion to be financed through each. (11.24 to 11.30)

Cash balances are held so the government can honour its commitments as they are presented for payment. Since the government pays more on what it borrows than it earns on its deposits, the size and efficient use of cash balances are important. This, in turn, depends on accurate forecasting of cash requirements. Improved information flows on expenditures, revenues and cash balances should help to achieve further cost reductions. (11.62 to 11.69)

Parliamentarians should be better informed about the full objective of the borrowing program, the performance of borrowing and cash management operations, and the linkages of the program to fiscal, monetary and regulatory operations and the wider economy. (11.78 to 11.80)

DEPARTMENT OF FINANCE
MANAGEMENT OF THE BORROWING PROGRAM

Introduction

11.1 Gross public debt outstanding has climbed from under $40 billion in the early 1970s to over $325 billion today, as illustrated in Exhibit 11.1. The increasing debt, together with higher interest rates, has pushed the costs of interest on the public debt up more rapidly than government expenditures on other programs.

11.2 Debt servicing costs have grown from about $4 billion or 10.6 percent of federal government expenditures in 1975-76 to $29 billion, or 23.3 percent, in 1987-88. Interest on the public debt is the largest single expenditure of the federal government. It is a statutory program; the commitment to pay interest is made when funds are borrowed.

11.3 As well, the Public Debt Program of the Government of Canada is a residual program. Its size is determined by a whole host of other policy and operational decisions – and by the wider economic environment. The officers of the Federal Debt Section of the Department of Finance, and their immediate superiors, are assigned the responsibility of advising the Minister on borrowing to meet the government's cash requirements. However, the Bank of Canada, as the government's fiscal agent, handles most of the administrative workload related to issuing debt, servicing outstanding debt and managing the government's cash balances. The Bank is the principal adviser to the Department of Finance on the management of the borrowing program and of cash balances.

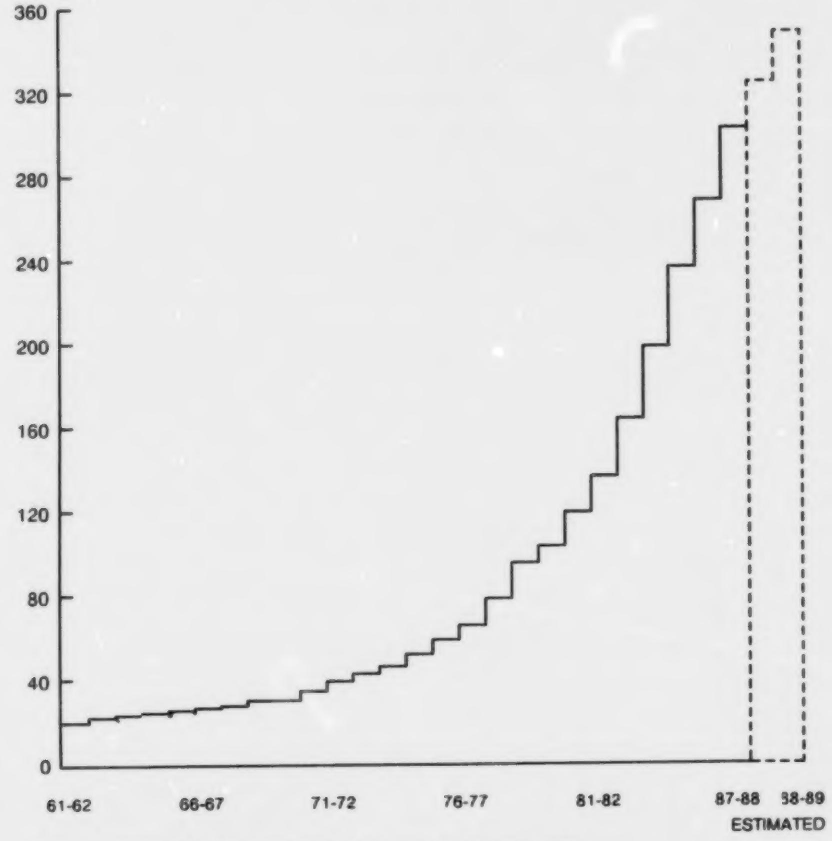
11.4 The program objective is to borrow to meet the government's cash requirements at the lowest cost over the long term, ideally without upsetting, by its very size, domestic financial markets or monetary policy operations. Federal government borrowing averaged about 34 percent of net domestic debt issuance in the 1970s; in the 1980s it has averaged around 58 percent (see Exhibit 11.2).

11.5 Program managers are responsible for decisions involving billions of dollars of gross borrowing and very large cash balances that must be controlled and appropriately invested. Cash balances are held at levels sufficient to honour the government's cheques when presented for payment. However, cash balances that are surplus to needs over even a short period lead to costs. Since the government pays more for the money it borrows than it receives on its bank balances, the spread between these rates combined with the level of excess balances determines the size of these costs.

11.6 The Federal Debt Section (FDS) generates recommendations for the strategic borrowing program and for short-term debt issuance and management of cash balances. Projections of the government's borrowing requirements are provided by the Fiscal Policy and Economic Analysis Branch at Finance and by the Bank of Canada. The FDS keeps records on future maturity schedules; thus it knows how much money is required to roll over maturing

Exhibit 11.1

GROSS PUBLIC DEBT
(Billions of current dollars)



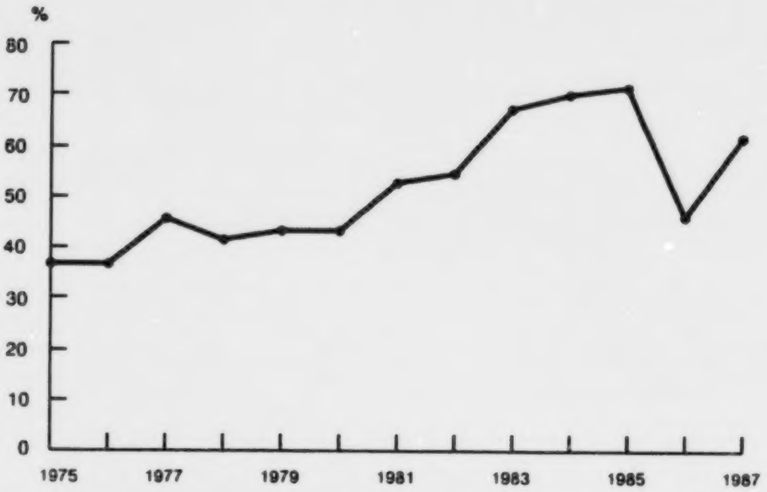
Source Department of Finance "The Fiscal Plan",10 February 1988

debt. It develops proposals for mixing the several debt instruments to be used for financing new and rollover issues in order to reduce costs by shortening or lengthening the average maturity of the overall stock of debt. It can determine the regularity of borrowing requirements under alternative future rollover schedules and can project the variation in costs associated with each of these alternatives, should interest rates unfold differently than generally assumed.

11.7 The FDS has no internal capacity to model the effects of rapidly changing financial markets on the borrowing program. Moreover, it cannot evaluate quantitatively the impact that its chosen strategies and tactics may have on financial markets and, through them, on the wider economy.

Exhibit 11.2

GOVERNMENT OF CANADA NEW BORROWING AS A PERCENTAGE OF NET ANNUAL DOMESTIC BORROWING



Note: This graph depicts Government of Canada net new debt issues as a percentage of the total net new security issues placed in Canada, excluding corporate issues of preferred and common stocks.

Source: Bank of Canada Review, March 1988

11.8 The FDS is thus heavily reliant on outside information. The major source of information, analysis and projections of borrowing requirements for the fiscal year is the Fiscal Policy and Economic Analysis Branch at Finance while information for daily cash management operations is provided by the Bank of Canada.

11.9 The Bank is also closely involved in the marketing and issuance of government debt instruments, relying on commercial banks and investment dealers to serve as the principal "wholesalers" for the government's marketable bonds and treasury bills. They, together with a wide array of other institutions, also promote and sell Canada Savings Bonds directly to Canadians.

Scope and Approach of the Study

11.10 Our study examined specifically the operations of the Federal Debt Section of the Department of Finance, including the documentation of planning and operational processes, and the systems in place for borrowing to meet the government's cash requirements and for controlling cash balances.

11.11 We assessed the extent to which the borrowing program was subject to evaluation for effectiveness and assessed the information provided to Parliament on the Debt Management Program.

11.12 The study also included a review of available literature and briefings by private sector experts. We interviewed managers of borrowing programs in two provincial governments and at large public utilities. As well, officials of the Bank of Canada provided a description of the Bank's activities that relate to issuing of new domestic debt and managing of the government's cash balances. At the Department of Finance, we interviewed program managers and officers and reviewed documentation on planning and operations pertaining to borrowing and cash management.

11.13 Because standard value-for-money criteria for auditing public debt operations were not available, our approach was to take the view of a prudent manager with regard to the information, systems, processes and documentation that could be expected to be in place. In the process, we developed criteria which were accepted by Finance. The criteria applicable in each case are set out before our observations.

Borrowing Program Environment

11.14 The Public Debt Program of the federal government is managed by the Federal Debt Section in the Department of Finance. However, the program title is somewhat misleading. Its managers have no designated role in planning, analyzing or directing the fiscal activities which are the dominant determinants of how large the public debt will be and how fast it will grow. Moreover, its managers do not administer the bulk of the expenditures that are allocated to this program's accounts. The Bank of Canada, serving as the government's fiscal agent and banker, sees to the payments of interest out of the Consolidated Revenue Fund (CRF) to holders of the public debt. For 1987-88, interest costs were estimated at $28.9 billion or 99 percent of total public debt program costs.

11.15 The key roles of the FDS are arranging for money to be borrowed to refinance maturing public debt and to meet new cash requirements of the government, and managing the level and disposition of the government's cash balances.

11.16 Borrowing to meet new cash requirements amounted to $24.5 billion in 1987. Gross borrowing to refinance maturing debt, cover CSB redemptions and meet new needs amounted to over $200 billion. Even very small variations on interest rates or yields can have big dollar impacts. However, program managers must accept the interest or yield that the market is willing to pay. They cannot force savers and lenders to buy government debt.

11.17 According to preliminary estimates by the Department of Finance, commissions on domestic bond issues amounted to over $170 million in 1987-88. These are paid to financial institutions for marketing Canada Savings Bonds ($17.5 billion, gross sales, in 1987-88) and Canada Marketable Bonds ($8.8 billion, gross commissionable sales, in 1987-88). The commission rates are set by the Department of Finance.

11.18 On the cash management side of the operation, large numbers are also at play. For example, the "cushion" of money held as demand balances throughout the banking system, to guarantee that the government's bills can be paid on time, averages about $800 million weekly. A number of substantial demands for immediate withdrawal from these balances might occur simultaneously. Any single cash requirement close to the magnitude of the cushion would almost certainly come from Exchange Fund operations; that is, Bank of Canada action, as the government's agent, to limit a sudden increase in the value of the Canadian dollar. In addition, the government holds enough cash in demand deposits to cover anticipated net expenditures until the next borrowing date. Average weekly budgetary expenditures during 1987-88 were approximately $2.4 billion. Interest rates on demand balances are, by formula, 2.5 percentage points below prime. However, on term deposits, even when they are of only a few days' duration, higher rates, determined by tender, apply.

11.19 Exhibit 11.3 provides a general overview of the linkages between activities and operations outside of the Federal Debt Section of the Department of Finance and its own responsibility for the borrowing program, including management of cash balances. The Bank of Canada is the sole source of daily and weekly projections of new borrowing requirements and of the government's cash balances in the banking system.

11.20 Moreover, the Bank, which actually issues the bonds and bills, keeps records on the participation of private sector dealers in the various public debt sales campaigns and on their performance in public debt marketing operations. Analysis of these records forms the basis for the Bank's allocation of Canada Marketable Bonds to dealers for sale on a commission basis.

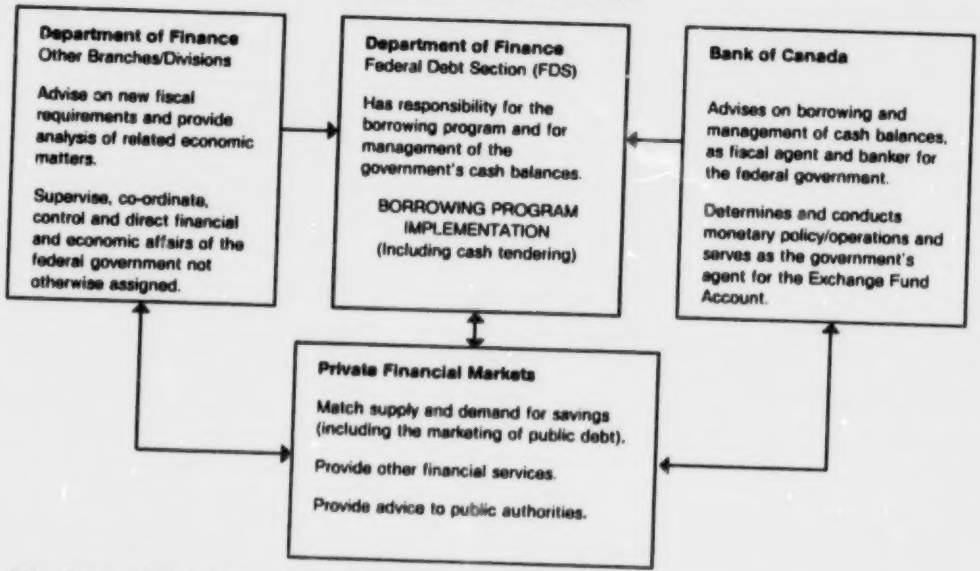
11.21 The FDS has its own set of records on maturing debt. This information is stored in a manner that allows simulations of future maturity schedules when different mixes of debt instruments and different issue-by-issue maturity profiles are assumed. It also allows managers to estimate the way in which interest costs would vary using different types and mixes of debt instruments under different assumptions about future interest rates. Most of the assumptions and fiscal projections for the upcoming months and years are developed in other branches of the Department.

11.22 The other major aspect of the debt marketing process is the role of private financial markets. They provide the means whereby savings in other sectors are applied to finance the deficit in the federal government sector. These financial markets have been moving toward greater global integration for some years now. This in turn has contributed to both greater non-resident purchases of the government's marketable bonds and bills (see Exhibit 11.4) and increasing volatility in the supply and cost of capital as funds move around the world to earn higher returns for given risk levels.

11.23 As well, the regulatory framework which governs financial markets has changed in recent years. In Canada, deregulation has allowed amalgamation of previously separate financial sectors or "pillars". Of particular interest here has been the coming together of certain banking and securities firms. However, other regulatory changes permit greater participation by non-resident firms in the Canadian securities market. On balance, the number of dealers authorized to participate in the competition to wholesale marketable federal debt (66 primary distributors in 1987) has remained high. As well, on average, the total of bids received from primary dealers exceeds the amount of bonds and bills being offered at auctions by a factor of almost three. Government borrowing authorities have the assurance of working within a competitive and sophisticated financial market framework.

Exhibit 11.3

LINKAGES BETWEEN ACTIVITIES AND OPERATIONS THAT AFFECT THE BORROWING PROGRAM



Department of Finance
Other Branches/Divisions

Advise on new fiscal requirements and provide analysis of related economic matters.

Supervise, co-ordinate, control and direct financial and economic affairs of the federal government not otherwise assigned.

Department of Finance
Federal Debt Section (FDS)

Has responsibility for the borrowing program and for management of the government's cash balances.

BORROWING PROGRAM
IMPLEMENTATION
(Including cash tendering)

Bank of Canada

Advises on borrowing and management of cash balances, as fiscal agent and banker for the federal government.

Determines and conducts monetary policy/operations and serves as the government's agent for the Exchange Fund Account.

Private Financial Markets

Match supply and demand for savings (including the marketing of public debt).

Provide other financial services.

Provide advice to public authorities.

Note: Arrows upward from Private Financial Markets indicate information feedback to public authorities

Borrowing Program Operations

Debt Instruments

11.24 The quality of federal government debt instruments sets the standard for all other borrowers. No other Canadian borrower has a higher credit rating; no other has such a large financing requirement.

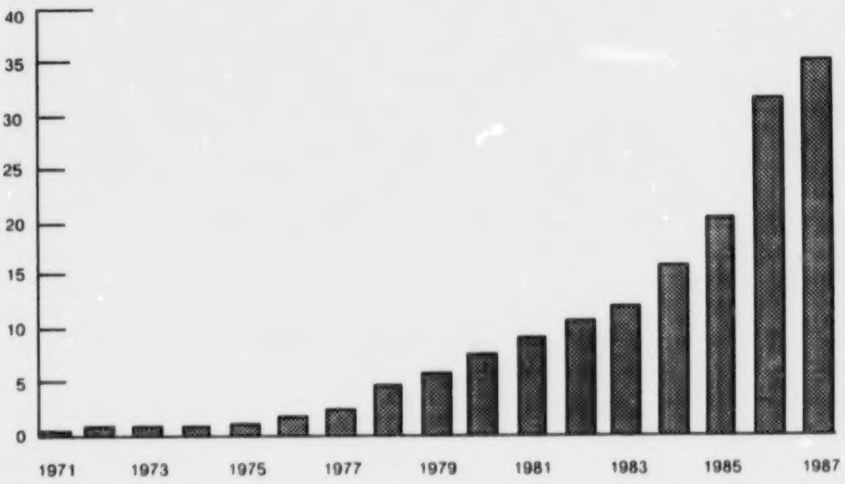
11.25 Although a variety of bonds and notes have been tested over the years, the vast bulk of publicly held debt is marketed as:

- Canada Marketable Bonds (CMBs), a fixed-rate instrument with terms of two years and over;
- Canada Savings Bonds (CSBs), a "retail" instrument, aimed at directly attracting personal savings;
- Treasury Bills (T-Bills), the key short-term instrument.

Exhibit 11.5 illustrates the proportions of these three instruments over the years. Exhibits 11.6, 11.7, and 11.8 describe these instruments and their recent marketing history.

Exhibit 11.4

NON-RESIDENT HOLDINGS OF GOVERNMENT OF CANADA DEBT
(Billions of current dollars)

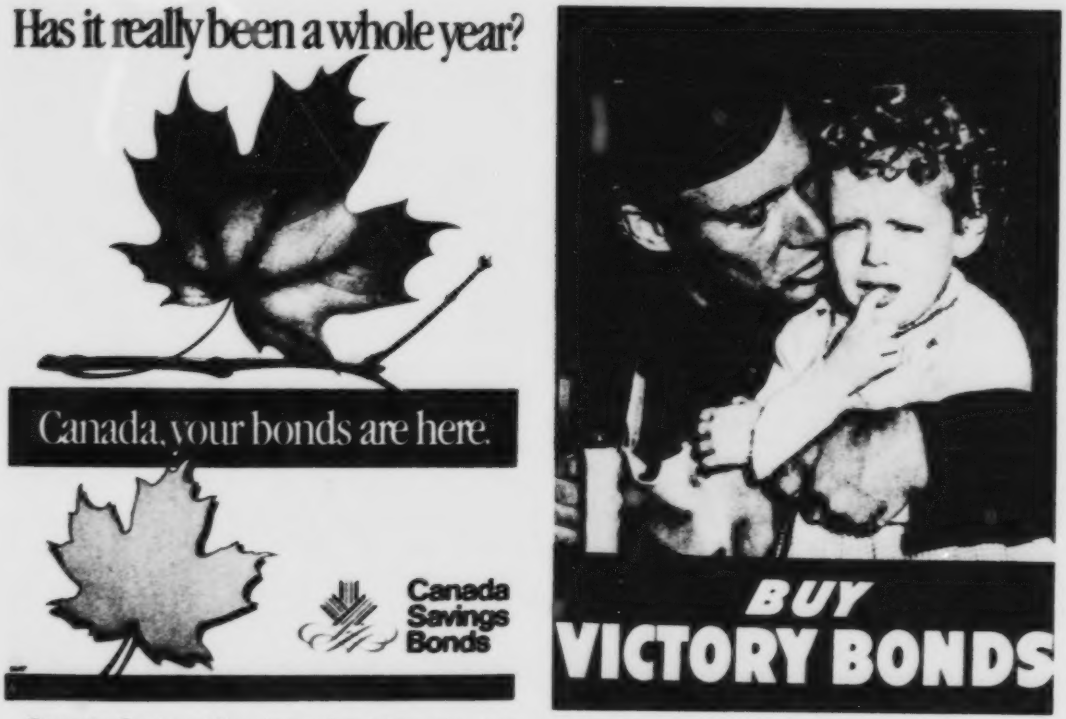


Note: Data depicted exclude non-resident holdings of debt of Government of Canada Crown corporations
Source: Bank of Canada Review, December 1980 and May 1988

11.26 **Audit criterion for debt instruments.** *Borrowing program decisions should be made only after all significant cost implications are taken into account.*

11.27 Interest costs make up the bulk of total borrowing costs. Thus, interest rate differentials, between instruments, are the most crucial consideration when determining the overall borrowing plan. Exhibit 11.9 illustrates the variation of interest rates among the several classes of debt instruments.

11.28 FDS officers also examine the non-interest costs associated with marketing and issuing the various forms of each major category of instrument insofar as these costs are charged to the Department of Finance. For instance, commission rates for CMBs are provided on the following page. The setting of these rates by Finance reflects the cost reduction objective of the FDS. Within the context of borrowing operations at Finance, there was no evidence to suggest that the above-noted criterion was not met.


Has it really been a whole year?
Canada, your bonds are here.
Canada Savings Bonds
BUY
VICTORY BONDS

Canada Savings Bonds evolved from the Victory Bond (see paragraph 11.25).

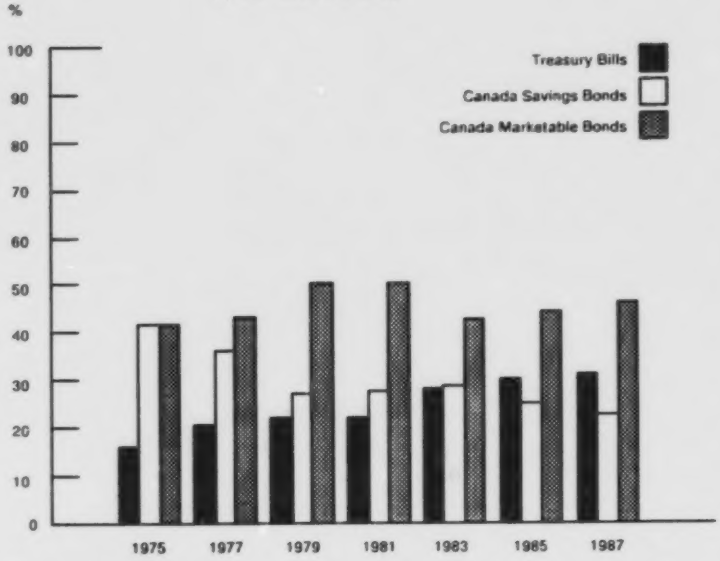
Commission Rates (Cents/$100 face amount):

From	2 yrs	3 yrs	5 yrs	7 yrs	10 yrs	Long
April 1977	20	25	50	–	60	75
December 1979	20	20	45	–	55	70
February 1980	20	20	40	–	55	70
June 1983	–	15	40	40	55	70
July 1983	–	15	35	40	55	70
October 1983	–	15	35	35	55	70
February 1985	–	20	30	35	45	60

11.29 However, the analyses are limited by the fact that the FDS does not have information on costs incurred by the Bank of Canada in its role as fiscal agent. The Bank's costs vary from one instrument to another and between some variants of a single instrument. The Bank's workload is disproportionately dedicated to servicing the CSB-based debt. This much is revealed by the descriptive material in some issues of the Bank's monthly Review and its annual report. Although interest costs dominate the total cost picture, for the CSB program the non-interest costs paid by Finance amount to more than the equivalent of a full percentage point of sales, at time of issue. In allocating its borrowing between different types

Exhibit 11.5

PERCENTAGE HOLDINGS OF GOVERNMENT OF CANADA DEBT INSTRUMENTS
(year-end basis)



Source: Bank of Canada Review, December 1984 and April 1988

of debt, the Department of Finance did not examine information on the additional non-interest costs incurred in servicing debt which are absorbed by the Bank.

11.30 To aid in decisions about what portion of the borrowing program should be made up of each of the different types of debt, the Department should arrange to obtain the Bank of Canada's cost estimates for fiscal agent services rendered without charge to the Department and the Public Debt Program.

> ***Department's response:*** *The Department agrees that borrowing program decisions should be supported by thorough analysis of all significant costs. However, the Bank of Canada's marginal costs for fiscal agency services - i.e. the amount by which the Bank's costs change in direct response to changes in the size of a particular component of the debt - at the present time are not considered to be significant enough to influence program decisions concerning the appropriate debt mix.*
>
> *A major constraint influencing the debt mix remains the size of the government's overall borrowing requirements; while there has been some decline in these requirements over the past three years, they are still sufficiently large to make it necessary to rely on all forms of debt currently being issued. Consequently, the ranges within which the volume of debt can be moved from one source to another are rather limited given the long-run minimum cost objective.*

For example, in the case of Canada Savings Bonds, the form of debt which incurs the highest proportion of the Bank's fiscal agency costs, the size of annual sales campaigns should be adjusted only within a reasonable range. The major components of CSB fiscal agency costs, in any event, are fixed and the marginal savings associated with a reasonable reduction in the size of annual CSB campaigns are estimated to be very small. Nevertheless, once the government's future borrowing needs decline well below current levels, the Bank's fiscal agency costs could become a more important factor in determining the appropriate debt mix. Within this context, the Department will obtain the Bank of Canada's estimates for its fiscal agency costs.

Strategic or Medium-term Decision Making

11.31 Internal departmental documents establish that the objective that guides the borrowing program has several sub-objectives: to meet the government's financial requirements through borrowing at least cost (over the long term), while avoiding significant disruptions to capital markets or the operations of monetary policy.

11.32 The first step in formulating the annual borrowing program is to determine the government's net cash requirements, including provisions for payment of interest and other servicing costs associated with the public debt. Information, analysis and projections are prepared for the government's proposed budget by the Fiscal Policy and Economic Analysis Branch at Finance. The Bank of Canada does its own projection of borrowing requirements, although some information is provided to it on a confidential basis from the Department of Finance. More detailed information is developed by Finance in preparation for tabling the Estimates. The Estimates present only the expenditure side of the fiscal accounts.

11.33 As well, the Department of Finance provides the Bank with confidential detail on projected new tax revenues and non-budgetary transactions. However, the Bank and Finance independently project several of the larger budgetary expenditures and all the direct and indirect tax receipts that make up budgetary revenues.

11.34 The Federal Debt Section is not greatly involved in the fiscal analysis or projection exercise carried on at Finance. It is, however, responsible for submission of a strategic plan for the borrowing program, by way of an annual Cabinet document, with the important background material being updated quarterly.

11.35 FDS officers, who are responsible for making strategic (and tactical) recommendations for the borrowing program, will consider several approaches to reducing interest and other costs. Through varying the mixes of the several debt instruments and the proportions of shorter and longer term components of the CMBs, the cost of debt servicing can be affected. This also has an impact on the average maturity of the debt.

Exhibit 11.6

CANADA MARKETABLE BONDS

A. **SOLD THROUGH AUCTION:** *to primary dealers; market directly determines the effective rate of interest; no commissions are paid; generally sold quickly; generally narrower marketing than bonds sold through the syndicate approach.*

Recent Illustration of Marketing Process
Bulletin - 9 December 1987: Minister of Finance announces $450 million 7 year 2 month non-callable bonds will be auctioned to primary distributors of Canada marketable bonds 15 December 1987.

Press Statement - 15 December 1987: Bank of Canada announces on behalf of the Minister of Finance that tenders have been accepted for $450 million 7 year 2 month Government of Canada non-callable bonds to be dated and delivered 5 January, 1988 and due 1 March 1995. The coupon rate was set at 10%.

B. **SOLD THROUGH SYNDICATE:** *Minister of Finance approves rates, terms, and conditions, and Bank of Canada allocates blocks of bonds to the syndicate of primary dealers following consultation with financial institutions to get their views of the market's appetite; bonds are then retailed with commissions (see below) paid on sales; commissions provide an incentive for firms to participate in other debt marketing operations and in the secondary market and to take the added risk of seeking to develop wider markets for these bonds than are achieved through the auction approach.*

Recent Illustration of Marketing Process
Bulletin - 13 January 1988: Minister of Finance announces a new issue of marketable bonds which will be offered 19 January 1988. Four maturities will be included in the issue: short, mid-term, 8-10 year, and long-term. Issue to be dated and delivered 1 February 1988.

Bulletin - 18 January 1988: Minister of Finance announces the total amount of the issue of $1,100 million and specific rates and maturities of the issue as well as a maximum limit of $350 million for the long bond.

Bulletin - 19 January 1988: Minister of Finance announces the price of each maturity within the $1,100 million issue.

Bulletin - 20 January 1988: Minister of Finance announces specific amounts of each maturity within the issue.

C. **CMB AS AN INSTRUMENT FOR DEBT MANAGEMENT**

Advantages

- Fixed rate and maturity date contributes a highly predictable element to cost projections and marketing plans.
- Appeals to large institutional pools of savings including pension and investment funds.
- Permits government to lock in when interest rates are low and are expected to rise.
- Reasonably flexible in that particular issues may be reopened, thereby reducing costs of raising addition funds.

Disadvantages

- Can lock government into relatively high interest rate debt should interest rates decline during the life of the bond(s).
- At a given time, interest rates/yields are higher than for shorter term T-Bills.
- Registered portion of the outstanding CMBs gives rise to considerable administration costs when these instruments are traded.

Exhibit 11.7

CANADA SAVING BONDS

A. **BACKGROUND:** *derive from wartime Victory Bond, but terms and conditions now vary from year to year; long planning lead-time required; small average sales ($5,631 for 1987-88); large number of sales each year, and outstanding bonds are held by about 5 million Canadians.*

Recent Illustration of Marketing Process
Bulletin - 25 September 1987: Minister of Finance announces a new issue of Canada Savings Bonds (Series 42) will be offered -- rates and further details to be announced mid-October.

Bulletin - 15 October 1987: Minister of Finance announces that Series 42 bonds will be offered at 9 percent interest in the first year. Individual purchase limit will be $75,000.

Bulletin - 23 October 1987: Minister of Finance announces the individual purchase limit has been reduced to $20,000. Strong demand anticipated in light of recent interest rate drops in Canada and abroad. Right reserved to terminate sale at any time.

Bulletin - 28 October 1987: Minister of Finance announces 1987-88 Series will be withdrawn from sale 30 October 1987.

Bulletin - 27 November 1987: Minister of Finance announces gross sales of the 1987-88 Series reached $17,450 million and net sales (after redemptions) were $14,913 million.

B. CSB AS AN INSTRUMENT FOR DEBT MANAGEMENT

Advantages

- Broadens the base of debt holding, thereby contributing to stability of debt marketing over the long term.
- Relatively low interest cost, source of money.

Disadvantages

- Uncertainty of redemption (held on average for 4 years but cashable, without penalty, after 3 months).
- Commission rate nearly 70 cents on $100 and other costs average over 30 cents on $100.
- High interest rates lead to sales target overshoot and vice versa but rates must be set well in advance.
- Interest rates must be adjusted for outstanding balance if current year's rate is higher, but not if it is lower.
- Period of grace to make cash payment, after interest starts to be earned, raises costs.
- High servicing costs reflected in the fact that 80 percent of number of certificates processed and interest payments made by the Bank of Canada on government debt is for CSBs.

Exhibit 11.8

TREASURY BILLS

A. **BACKGROUND:** *mix of 3, 6 and 12 month maturities varied to roll over maturing debt and attract a wide range of institutional and, increasingly, individual buyers; auctioned weekly; special variant (Cash Management Bill) with 10 to 44 day maturities is issued on occasion to bridge unusual, but generally anticipated, short-term shortages in the CRF, such as redemption of CSBs just before a new issue.*

Recent Illustration of Marketing Process
Press Statement - 5 May 1988: Bank of Canada announces on behalf of the Minister of Finance that tenders had been accepted for $3,600 million of Government of Canada Treasury Bills to be dated and issued on 6 May 1988. Issues were as follows:

Amount	Term	Average Yield
$2,050,000,000	3 Months	8.87%
$1,000,000,000	6 Months	9.18%
$550,000,000	12 Months	9.49%

At last week's tender the average yields were 8.87% on 3-month, 9.21% on 6-month, and 9.45% on 12-month Treasury Bills. Tenders to be received on 12 May 1988 for $3,250 million government of Canada Treasury Bills to be dated and issued 13 May 1988. Of this total amount $1,800 million will be 91-day bills, $900 million will be 181-day bills, and $550 million will be 364-day bills.

B. T-BILL AS AN INSTRUMENT FOR DEBT MANAGEMENT

Advantages

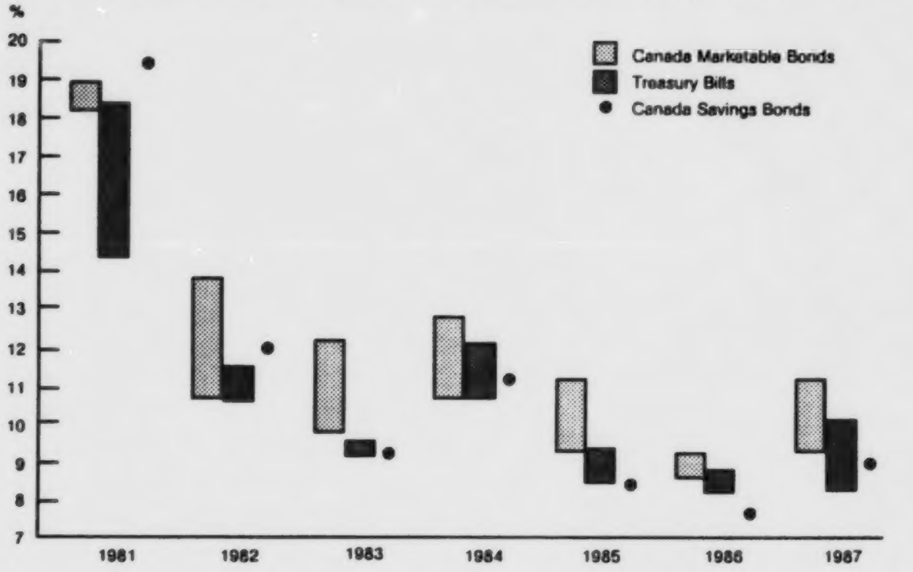
- Sold at discount so no interest payments are made directly to buyers/holders thereby reducing administration costs.
- Sold by auction and administered by automated means.
- Appeals to a very wide market including, increasingly, individuals.
- At a given time, costs of borrowing are usually the lowest of optional instruments.
- Allows quick reaction to changing cash requirements and, therefore, is the principal cash management tool.

Disadvantages

- Frequent rollover of the debt carries the risk of large financing costs when interest rates are high in the short run and of contributing to volatility when markets are uneasy.

Exhibit 11.9

COMPARISON OF YIELDS ON GOVERNMENT OF CANADA SECURITIES



Note: Bars represent the range of interest/yield for all issues during October and November of the years indicated.

Source: Bank of Canada
Department of Finance

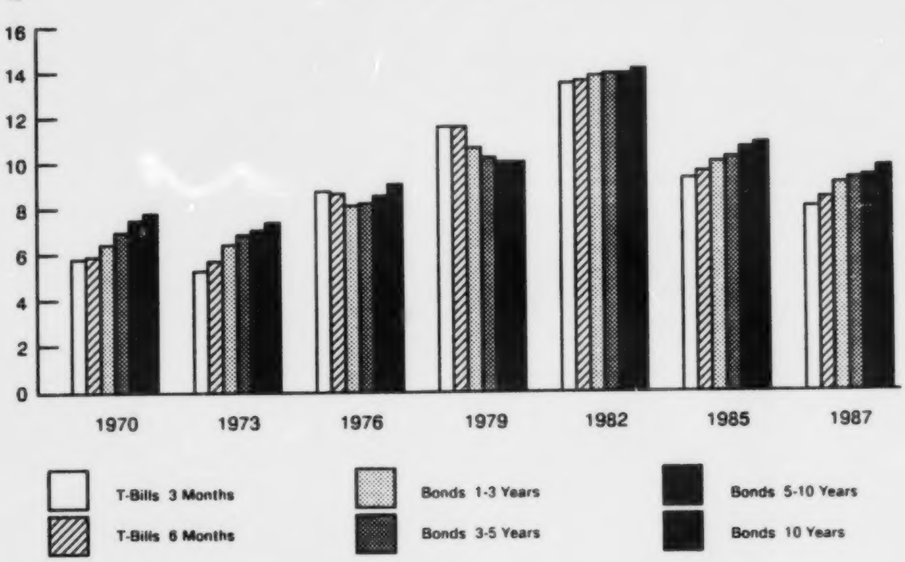
11.36 Over the long term, whenever interest rates are stable, short-term rates tend to average out below longer-term rates (see Exhibit 11.10). This "positive yield curve" suggests that interest costs could be minimized by holding debt in a short-term or "floating" form. However, as Exhibit 11.10 also shows, short-term rates can sometimes be higher than long-term rates, as in the late seventies. Moreover, interest rates have been volatile in recent years.

11.37 Opportunities to reduce interest costs arise when general interest rates vary and changes are correctly anticipated over the medium term. To implement this strategy, managers would choose different mixes of instruments to achieve a reduction of the average term to maturity of the debt when current rates were thought to be high and were expected to decrease in the future. When interest rates were low and expected to increase, managers would attempt to increase the average term to maturity. FDS officials do not try to outguess the market; interest projections or assumptions are provided to them. However, given such assumptions, they develop recommendations following the above logic.

11.38 The FDS examines the public debt charges that emerge as a result of projecting various mixes of debt issuance into the future, given outside forecasts or assumptions respecting fiscal conditions and interest rates. As well, background studies test these alternatives to determine the effects on interest costs should the assumed interest rates turn out to be higher or lower.

Exhibit 11.10

GOVERNMENT OF CANADA AVERAGE SECURITIES YIELDS
(Percent annually)



Source: Statistics Canada

11.39 **Audit criterion for borrowing strategies.** *Borrowing strategies should be developed, based on the overall objective of borrowing appropriate amounts at appropriate times and at least cost, given constraints.*

11.40 The annual submission to Cabinet on the borrowing program represents the strategic plan for the fiscal year and sets the framework for the borrowing operations to come. It is developed from a schedule of borrowing requirements corresponding to the forecast debt rollover and new fiscal needs and, in this way, meets the criterion of borrowing the appropriate amounts at appropriate times, over the coming year.

11.41 **Specification of a least-cost strategy.** The program objective explicitly recognizes constraints which may require that trade-offs be made from time to time. There is no question that, in a general way, these trade-offs are recognized and rationalized.

11.42 However, there is no estimation of a least-cost strategy or base case which could serve as a yardstick against which the benefits and costs of alternative strategies might be assessed. Since the federal government is the country's largest borrower and has the highest credit rating by virtue of its wide taxing powers, it is reasonable to expect that the borrowing program should be managed to avoid negative impacts on financial markets. Clearly, single-minded pursuit of cost minimization for the borrowing program is not necessarily optimal for the economy as a whole. Thus, alternative strategies which allow for secondary objectives, constraints, opportunities and risks may be required. Estimation of the costs of pursuing these other strategies would be reflected in the divergence of such alternatives from the least-cost strategy. The benefits would be more difficult to estimate but their specification would allow clearer focus on program effectiveness.

11.43 A similar perspective on the development and use of least-cost approaches can be applied to strategic target setting; the least-cost alternative or base case is used as a standard against which other alternatives are assessed and justified. The four strategic dimensions of note are:

- the proportions of debt to be held in short-term (or floating) and in long-term (or fixed) form;
- the proportions of debt to be held in each debt instrument (given the previous point);
- the proportions of marketable debt to be placed through the auction process (and, implicitly, by the traditional or syndicate allocation method); and
- the introduction of new instruments and approaches to borrowing and cash management.

11.44 In each of these four dimensions there are considerations in addition to raising funds at least cost. These are discussed below.

11.45 **Term to maturity.** As noted earlier, program managers will deliberately attempt to adjust the average maturity profile. This would reduce interest costs, assuming that the forecasts provided to them correctly anticipated the direction in which interest rates were moving and the market took up new issues of the government's debt as hoped.

11.46 But the target maturity profile is also set to spread the cost of debt servicing more or less evenly over time. A rather stable portion is held in fixed- or long-term debt to avoid (to some extent) the risk (and thus the extra cost) of having to undertake a more massive rollover when short-term rates are volatile or exceedingly high. In addition, the persistent, large fixed- or long-term portion is also thought to reduce the chance of the government's borrowing operations upsetting capital markets and monetary policy operations.

11.47 As a matter of record, the average maturity of the public debt has been gradually reduced from over seven years in 1979 to under five years for 1987. The principal logic behind the implementation of this strategy has been to reduce the maturity profile in times of high interest rates. There is no elaboration, however, of other objectives behind this change or why the degree of reduction has been as small or large as it has turned out to be.

11.48 **Proportion of debt, by instrument.** Each class of instrument is designed to operate in a particular but broad market niche. In that sense, these instruments are complementary. Substitution of one instrument for another is used to shorten or lengthen the average maturity profile. In this context, processes are in place to evaluate the impact of alternative instruments on interest costs and on the maturity profile.

11.49 However, the strategic decisions respecting the proportion of debt to be targeted for each instrument consider other matters as well. For instance, different instruments may be used to tap distinct pools of savings. It is generally considered that the federal debt should be marketed as widely as possible to ensure that cash requirements can be met and to minimize the likelihood that large borrowing by the government will add to interest rate volatility. There is no quantification, even in terms of broad estimates, of the cost or benefits associated with such secondary considerations.

11.50 **Proportion of CMB placements, by auction/allocation.** Until five years ago, CMBs were sold through dealers who were allocated amounts determined, in part, by their previous performance in marketing public debt. Since then, CMBs have been auctioned, as well as sold by syndicate. Currently, about 50 percent of CMBs (and all T-Bills), are sold through auction. Yields are determined by active, competitive bidding at the moment of auction. The competitive determination of price and yield through auction is considered appropriate in terms of cost-minimization for the seller and normal economic profits, over the long haul, for the primary buyers. There are, however, secondary but important considerations for managers of the borrowing program and their advisers. For example, maintaining strong competition in auctions for both T-Bills and CMBs, and an active secondary market for liquidity purposes, could be more difficult as the incentive provided by commission sales through the syndicate is reduced.

11.51 Our examination indicated that explicit comparisons were made of the costs of a variety of combinations of the traditional allocation approach to marketing CMBs and the auction procedures. There was not, however, any calculation of the benefits flowing from the different approaches. Admittedly, the full costs and benefits associated with the two alternative approaches may be difficult to quantify. However, greater specification of the costs and benefits would provide a more objective foundation for decisions.

11.52 **New approaches and instruments.** In addition to ongoing investigation into borrowing at the lowest available rates of interest, the FDS, with advice from Bank of Canada officials, also examines and reports on strategies for reducing the cost of marketing and other non-interest expenses. For instance, commissions have been reduced (as illustrated in paragraph 11.28).

11.53 The background material to the annual Cabinet document will discuss these broad considerations and, from time to time, specific options such as new debt instruments and techniques. Besides cost reductions, new approaches and instruments may be considered for their contribution to broadening the market for government debt, the benefits and indirect costs of which are rarely specified.

11.54 **The Federal Debt Section should assess the feasibility of projecting a least-cost, long-term borrowing strategy that could serve as a yardstick (base case)**

against which the costs and benefits of allowing for secondary program objectives and other constraints, opportunities and risks could be specified.

> ***Department's response:*** *The Department will undertake an assessment of the feasibility of this approach to analyzing alternative borrowing strategies. It is not clear, however, that such an approach, if it proves workable, would yield results appreciably different from those resulting from the approach presently used by the Department. That approach follows from the borrowing program's objective of raising the government's cash needs at minimum long-term cost. The Department develops various debt program alternatives and compares their estimated costs to the alternative of continuing with the strategy currently in place. Alternative strategies which promise to reduce costs are further developed to yield what are judged to be maximum savings given market conditions. As a practical matter, given the large size of the government's debt relative to the total market, the extent to which the government can alter its debt strategies is limited by the potentially adverse impact of large or sudden changes in strategy on markets and hence on its borrowing costs. Assessing this impact is, in large part, a judgmental process that may not lend itself to precise quantification. Although the Auditor General's suggestion that a hypothetical least-cost alternative be developed is an untested concept that, to our knowledge, is not employed by other large sovereign borrowers, the Department will give it further consideration.*

Strategic Adaptations

11.55 Documents provided to Cabinet do not explain, in terms of quantitative estimates, the relative costs of raising cash requirements through different strategies. However, many strategic decisions have been made that should, logically, contribute to lowering the effective rates of interest and other costs:

- Increasing the Treasury Bill (short- or floating-term) portion of debt through the 1980s – as interest rates remained high (Exhibit 11.10).
- Reducing commissions on marketable bonds and savings bonds.
- Earning interest on all government deposits from 1985 on and establishing a practice, in 1986, of competitive tendering to place "surplus" cash balances in private financial institutions.
- Reducing savings bonds (payroll loan system) costs, in 1986.
- Launching auctions of marketable bonds in 1983 and expanding this to about 50 percent of total CMB sales by the end of 1987.
- Pricing marketable bonds (allocation process) on the morning of sale rather than the evening before, to engender pricing that reflects overnight movements of international capital, in 1987.
- Increasing the use of "reopenings" (new bonds issued with the same rate and maturity date as an existing bond) of previous CMB issues, to expand a particular maturity and thereby increase its liquidity and reduce incremental marketing costs.

- Initiating a Canadian dollar interest rate "swap" program, where a fixed public debt liability is effectively exchanged for floating or short-term private liabilities, to reduce short-term, effective interest costs for the government, in 1987-88.
- Pricing syndicated bond issues at market rather than 1/8 percent to 1/4 percent below the market.

These efforts on the part of the authorities at Finance reflect an ongoing commitment to cost reduction, given that the government's cash requirements must always be met.

Tactical or Short-term Decision Making

11.56 In the main, the market determines the effective rate of interest. However, tactical program decisions are also significant. They relate to the amount of debt to be sold at a given time. For certain debt instruments, other terms and conditions are also set by program managers just before marketing.

11.57 **Forecasting borrowing requirements.** To assess the market's appetite for government debt, an intelligence gathering system solicits the opinions of private financial institutions. The Bank of Canada has a very extensive consultative system; the FDS system is much more modest, since its main purpose is to serve as an independent cross-check.

11.58 Of critical importance, from the standpoint of economy, is that the "right" amount of money be borrowed on any entry into the market. While the FDS knows the amounts required for rollover of maturing debt, it relies solely on the Bank of Canada for a detailed, daily projection of cash balances and new (net) cash requirements for the time until the next T-Bill auction (considering also the CMB and CSB sub-programs). The Department of Finance projects new fiscal requirements only on a monthly and longer-term basis.

11.59 The ultimate decisions rest with Finance, from the borrower's side; competitive market forces condition the suppliers' side. Monetary operations can affect both sides of the financial market. Given these several determinants of any bond or bill price, it is difficult to predict exactly when the government should enter the market, for how much, and on what terms and conditions. Even after the fact it is not easy to distinguish the ideal marketing tactic.

11.60 **Audit criterion for determining borrowing requirements.** *Systems and processes should be in place to:*

- *evaluate near-term borrowing requirements; and*
- *provide a reasonable basis for relying on information inputs from outside sources.*

The FDS is responsible for recommending the borrowing to be undertaken from week to week. It relies for daily and weekly projections of new borrowing requirements on the Bank of Canada's knowledge of the government's balances in the banking system, on its familiarity with exchange market activity, and on its estimates of fiscal inflows and outflows. As noted earlier, the Department projects fiscal flows on an annual and monthly basis; this provides FDS with a basis for evaluating the Bank's shorter-term forecasts. In this general way, the above criterion is met. Finance could also forecast these flows daily and weekly. In the imprecise world of economic forecasting, there is value and protection in having two or more independent projections of future financial requirements. Where differences between estimates are significant, reconciliation can contribute to the quality of both forecasts and to more confidence in recommendations built on the results of the reconciliation.

11.61 The Department of Finance should develop a capacity to forecast new fiscal requirements on both a daily and weekly basis. Given that the officers of the Federal Debt Section and their immediate superiors are responsible for final borrowing recommendations, the unit should have the capacity, in systems and personnel, to challenge forecasts provided to it and to help reconcile any significant differences when required.

> ***Department's response:*** *The Department will give further consideration to this suggestion. However, it has some reservations about the utility of duplicating the daily cash forecasting activity at the Bank of Canada. Unlike a longer-term cash requirements forecast (monthly, yearly) where considerable judgment about economic conditions is required, the daily cash forecast is more a management information system, gathering short-term revenue and expenditure projections across government operations.*

11.62 **Managing cash balances.** The borrowing program operates on the premise that the government must always have sufficient money on hand to meet its payment obligations. Forecasts of cash requirements, even a few days in advance, can be very different from actual needs. Exchange Fund operations can cause large outflows from, or inflows into, the CRF. The CSB redemption rate is often widely different than expected. Also, annual sales of CSBs often are hard to predict accurately. Large, unanticipated inflows and outflows of funds sometimes occur. The volatility of weekly cash balances is clearly illustrated in Exhibit 11.11.

11.63 One way to insure against running out of money is to hold enough to cover expected needs before the next borrowing plus a cushion to cover the worst possible unexpected shock. However, relatively low interest rates apply on such a demand balance. The more of these balances that are put in term deposits – and the longer the term – the less are the opportunity costs to the government. Weekly, or more frequently as required, surplus funds are tendered to term deposits. Exhibit 11.12 illustrates the proportions of monthly cash balances that have been held in term and demand deposits.

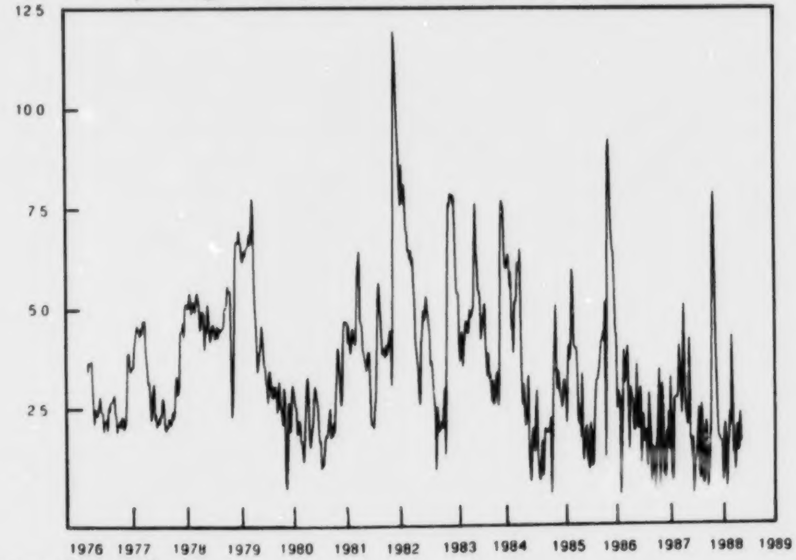
11.64 **Audit criterion for managing cash balances.** *Systems and processes should be in place to manage cash balances so that opportunity costs are minimized, consistent with the need to meet the government's cash requirements.*

11.65 Exhibit 11.11 shows that, over recent years, there has been a downward trend in the government's cash balances relative to the volume of activity. Moreover, the amounts of cash balances held as term deposits (with relatively high interest rates applying) have become

Exhibit 11.11

GOVERNMENT OF CANADA DEPOSITS

(Average weekly balances in billions of dollars)

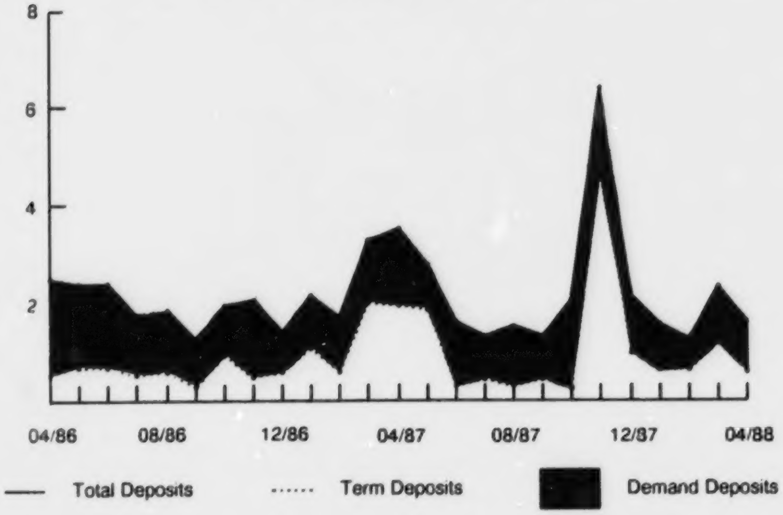


Source: Statistics Canada

Exhibit 11.12

GOVERNMENT OF CANADA DEPOSITS

(Average weekly balances in billions of dollars)



Source: Statistics Canada

proportionately higher, and those kept as demand deposits (projected needs plus the cushion) have become smaller, as shown in Exhibit 11.12, to reduce costs.

11.66 The existence of the cushion reflects the traditional objective that there must always be enough cash on hand to avoid having to borrow from the Bank of Canada in order to meet payment obligations. Having to borrow from the Bank would affect balances held in the financial system for the purpose of controlling the money supply. The current estimate by FDS of an optimum cushion is $800 million. However, no estimates have been developed of the cost savings that might be realized should unanticipated cash requirements be met through borrowing from the Bank of Canada rather than by holding a cash cushion. This cost information is essential in determining the optimum level of the cushion and, therefore, demand deposits.

11.67 Demand deposits are held to meet net cash requirements until the next debt issuance. The FDS works on forecasts of net or residual cash requirements rather than flows of expenditures and revenues which give rise to them. On the revenue side, the precise timing of inflows is not completely within the government's control. However, it should be possible to avoid large unexpected budgetary expenditure payments between T-Bill auctions.

11.68 There appear to be opportunities for mathematical-statistical modelling of the cash balances process that could assist managers to develop more precise tactics and criteria for optimizing cash balances, the amount of the cushion and the amounts to be tendered to term deposits. Such modelling would require improved documentation of criteria, operational decisions and results achieved.

11.69 The Department should examine the feasibility of putting into place systems and processes to enhance the quality of cash requirement forecasts and the documentation of operational decisions and results, so that criteria and operational plans can be appropriately revised on an ongoing basis.

> ***Department's response:*** *Considerable progress has been made in the cost-effective management of the government's cash balances since the commencement of new banking arrangements in 1986. In particular, the level of lower yielding demand balances has been reduced. The extent to which demand deposits can be further reduced, however, is limited by, for example, uncontrollable variances in revenues and by the amount needed to cover unforeseeable foreign exchange intervention demands. In recent months these currency intervention demands have been considerable: for example, in June 1988, Cdn. $3.7 billion (net) was required, with most of this occurring in the space of a few days.*

The Department has already launched a study of the cost-effectiveness of further improving the quality of information used to make cash management decisions. The Department will also examine the feasibility of putting into place systems and processes to enhance the documentation of cash management operational decisions and results.

Program Evaluation

11.70 The borrowing program's primary objective is to raise the money the government requires above and beyond its budgetary and non-budgetary revenues for the current year. Authority is provided through annual Borrowing Authority Acts and under Part IV of the Financial Administration Act (FAA). The annual Cabinet document sets strategic objectives and targets to achieve planned cost savings as well as to assure that borrowing corresponds to the annual fiscal plan, divided into monthly segments.

11.71 As time passes, the FDS compares actual borrowing activity against the annual plan. Quarterly, the relevant data are updated for Cabinet's information, with significant deviations from the plan highlighted and explained. An accounting model is used to keep track of remaining balances of authority granted through the Borrowing Authority Act (or Section 39 of the FAA, if necessary). A second Borrowing Authority Act in a given fiscal year may be anticipated when actual borrowing outpaces the planned amounts. Transactions related to operations of the Exchange Fund Accounts (which are not projected for annual planning purposes) occasionally give rise to unanticipated shortfalls in borrowing authority in relation to the initial Borrowing Authority Act. Processes and systems in place evaluate satisfactorily how well the program is fulfilling its objective of meeting the government's cash requirement.

11.72 While strategic targets are also developed with the objective of reducing direct borrowing costs, there is no specific explanation of the relationship of such targets to the program objectives of avoiding destabilizing effects on capital markets and of maintaining compatibility with the broad aims of monetary policy operations.

11.73 With respect to the objectives of the program, it should be noted that after completion of our review, we were informed by the Federal Debt Section that they have redefined the program as having a single objective: to meet the Government's financial requirements while minimizing total expected debt costs over the long term. Consideration of other relevant federal programs, particularly those falling under monetary, exchange rate and financial market policies, is still seen to be important. These considerations are now treated as constraints rather than areas in which the borrowing program activity seeks to achieve a secondary program objective. Borrowing program managers maintain that, over the long term, these constraints reinforce, or at least do not mitigate, the achievement of the least-cost objectives. There is no documentation of borrowing decisions over the long term to verify this contention.

11.74 There may be no precise method of determining the benefits of pursuing program objectives other than least-cost, or of making allowances for other constraints, opportunities and risks that confront program managers. For instance, the question of how much higher (if at all) the cost of servicing the public debt would be if the borrowing program explicitly sought to avoid conflict with monetary policy operations, is not asked, let alone answered. However, the onus of justifying any incremental costs of pursuing these other ends rests with their proponents.

11.75 Government-wide policies on program evaluation are not applied to the borrowing program operations. Greater specification of the way in which strategic and operational targets work toward the program's objectives could serve as a first step in fully evaluating program effectiveness.

11.76 The Federal Debt Section should initiate procedures wherein program objectives, constraints, opportunities and risks are specified and results are assessed against projected least-cost and other performance targets. This would constitute a first step in evaluation of the effectiveness of the borrowing program for ends other than meeting the Government's cash requirements through borrowing. As well, an assessment should be made of borrowing program operations to determine what steps are required to comply with government-wide policies on program evaluation.

> ***Department's response:*** *The borrowing program's objective, constraints, opportunities and risks are specified and discussed in the annual Memorandum to Cabinet which sets out the recommended borrowing plan for the coming year. The primary objective of the program is to ensure that the government's borrowing requirements are met while minimizing total expected long-run debt costs. The Department also assesses on an ongoing basis the performance of the borrowing program. This assessment takes the form of, for example, post-analyses of new debt issues and quarterly reviews for Cabinet. As noted earlier, there are conceptual difficulties with specifying precisely a least-cost borrowing base case for planning purposes since significant changes in government debt strategies would likely result in market reactions that would adversely affect costs. Accordingly, a significant degree of judgment in managing debt operations is required. These factors reduce the utility of formal cost-benefit analysis for borrowing program decision making. However, additional benefit might be derived from a more specific evaluation of the borrowing program's effectiveness. Accordingly, the Department will examine the feasibility of applying more formal program evaluation techniques to the borrowing program operations.*

Reporting to Parliament

11.77 A considerable amount of information is published on Canada's public debt and the annual costs of servicing it. The Public Accounts provide complete details on unmatured debt. The annual Fiscal Plan document which accompanies the Budget provides background data and analysis of the run-up in debt, and projections of debt level and annual servicing costs, for the present and several upcoming years. The activity of debt issuance is publicized through announcements of borrowing intentions and press releases on borrowing activities. The Annual Report of the Governor to the Minister of Finance and other more frequent publications provide descriptions of the Bank of Canada's activities with respect to management of debt and cash balances as well as related administrative services.

11.78 As explained in Chapter 5 of this Report, Information for Parliament, Part III of the Estimates was designed to be a dual-purpose document containing information on both planned expenditures and actual performance. In that context, the section on the Public Debt Program in Part III of the Department of Finance Estimates is inadequate. Chapter 5, Exhibit 5.5, suggests information that might be included. It should be noted that the FDS plays very little part in developing the Part III document.

> ***Department's response:*** *A great deal of information related to the public debt, in addition to that contained in Part III of the Department's Estimates, is provided to Parliament in other documents, notably the Budget Papers. The Department will examine ways to provide in Part III adequate cross-references to this material. Also, the Department will examine ways to provide more detailed information in Part III to further explain year-to-year fluctuations in costs.*

11.79 In Chapter 1 of this Report, the Auditor General proposes that Parliament examine debt control and the management of the borrowing program with more deliberate focus than previously. Parliamentary debate on the proposed Borrowing Authority Act would provide an opportunity to do this. Some significant part of the background information that would be required to serve that purpose could be developed by the FDS with input from its advisers elsewhere in Finance and at the Bank.

11.80 Background material on borrowing program activity, required for Parliament's expanded consideration of debt management in the context of debate on the Borrowing Authority Act, would include:

- a clear statement of the full objective of the borrowing program (Part IIIs now claim that the objective is merely to borrow to meet the government's cash requirements);

- an outline of the major strategies available to management of the borrowing program and the significance of the principal trade-offs between alternatives;

- an accountability document to report on actions taken by borrowing program officials to avoid or minimize the possible adverse effects of government borrowing on financial markets; and

- a proposed program for the coming years, with basic assumptions and strategic thrusts for the coming fiscal year, keeping in mind the constraints imposed by the commercial nature of the borrowing operation.

DEPARTMENT OF FINANCE
MANAGING THE INCOME TAX INFORMATION BURDEN

DEPARTMENT OF FINANCE
MANAGING THE INCOME TAX INFORMATION BURDEN

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Department's Response

Exhibit

12.1 Cost Framework for the New Tax Assisted Retirement Savings Rules

12

DEPARTMENT OF FINANCE
MANAGING THE INCOME TAX INFORMATION BURDEN

Main Points

Policy initiatives implemented through the income tax system impose a significant information burden on corporate and individual tax filers, on third parties, and on the Government itself. (paragraphs 12.13 to 12.23)

In the design of the refundable tax credits examined in this study, the Government considered on an ad hoc basis various aspects of the information burden. In general, a more structured analysis is feasible. (12.24 to 12.32)

For the two tax measures we examined that affect corporations, the Government engaged in consultations with the private sector. One outcome of this consultation was modifications that reduced the magnitude of the information burden. (12.33 to 12.41)

We estimate that one major proposal, affecting certain corporations in their role as providers of information concerning their employees, will involve one-time costs to these corporations in the order of $330 million (1988 dollars). Approximately $170 million represents the cost for review and possible amendment of existing plans, approximately $100 million represents the costs of providing information and counselling to plan members, and approximately $60 million represents the cost of setting up systems to report information to the Department of National Revenue-Taxation. A further annual cost in the order of $15 million will be incurred to comply with reporting requirements. The ultimate incidence of these costs will depend on the corporations' ability to shift the costs to others. The Government's disclosure of the impacts of this proposal has not included an estimate of such costs. (12.14 to 12.18 and 12.37, 12.38)

DEPARTMENT OF FINANCE
MANAGING THE INCOME TAX INFORMATION BURDEN

Introduction

12.1 The income tax system, because of its complexity and the volume of data that must be managed, imposes an information management burden on those who come into contact with it. Taxpayers, the administrators of the system – the Department of National Revenue-Taxation – and third parties such as employers who are responsible for providing important tax-related information on their employees, are all affected. In turn, the income tax system in Canada, as in most countries, is highly dependent on the reliability, accuracy and speed with which information is obtained, stored, processed and disseminated.

12.2 Even though successive governments have had the objective of simplifying the system, its use over the years as a mechanism for delivering government programs and for achieving socio-economic objectives has contributed to its increasing complexity.

12.3 Many of those who must provide the information that makes the system work view this role as increasingly burdensome. For both corporate and individual taxpayers, tax measures, or the way they are administered, have a direct cost impact. Corporate taxpayers and small businesses employ professional advisers such as accountants and lawyers to help them comply with the tax system. In their role as "third party" information providers, many businesses have to employ extra staff or develop special information systems.

12.4 Many individuals use professional tax return preparation services to help them comply. But even individuals who do not use these services incur a cost in the sense that they must devote time to tax return preparation. For some individuals, a potential impact of the information burden might be an inability to understand the system well enough to take full advantage of the deductions and credits it allows.

12.5 In light of these factors, it is fair to say that the management of information burden in our tax system is a matter of significance, and that the impact of this burden on taxpayers and others is an issue worthy of consideration in the design of new tax measures.

Objectives, Scope and Approach

12.6 The objective of the study was to determine the extent to which the information burden is taken into consideration in the design of new tax measures. The intent was to establish whether and how the information burden implications of a new tax measure are weighed against policy objectives, and whether alternative means of achieving policy objectives, with less information burden, are taken into consideration.

12.7 It also considered how well the information requirements of new tax measures are disclosed to those affected before legislation is enacted; and how effectively the impact is evaluated after legislation is passed.

12.8 It is important to acknowledge that it would not be reasonable to expect the information cost associated with a tax measure to be zero. The issue is whether due regard is paid to economy and efficiency, considering both the Government's costs and the costs of those outside the Government. This issue is present whether or not the use of the tax system as a delivery vehicle is contemplated. For example, a tax expenditure program and a direct expenditure program both are likely to involve information costs for the Government and others. A fundamental principle for ensuring that due regard is paid to economy and efficiency is to ensure that costs are made visible.

12.9 The scope of the audit covered four tax measures proposed, introduced or modified over the last 10 years:

- The **Refundable Research and Development Investment Tax Credit**. This measure provides an incentive to corporations and individuals to incur qualifying research and development expenditures. In 1985 this tax credit was made fully refundable for certain corporations.

- The **Federal Sales Tax Credit**. This measure, introduced in 1986, provides individuals and families with a refundable tax credit that is reduced by family income over a certain level.

- The **Child Tax Credit**. This measure, introduced in 1978, provides the parent receiving the family allowance payment with a refundable tax credit that is reduced by family income over a certain level. In 1986 the measure was amended to provide for advance payment of the credit.

- The new **tax assisted retirement savings rules**. These rules were detailed in a document issued by the Government in October 1986. Draft legislation, reflecting some change to the rules as presented in October 1986, was released in March 1988 but is not yet law. The goal of these rules, which determine the maximum annual contributions to a registered retirement savings plan (RRSP), is to provide equal tax assistance to all taxpayers, regardless of the type of plan.

12.10 These four measures were chosen because they represent a good cross-section of measures that affect individuals, corporations, the Department of National Revenue-Taxation and third party information providers.

12.11 Because the tax assisted retirement savings rules have not been passed into law, our comments in this chapter serve as a progress report. We will review the status as part of our regular follow-up activity and will report further any significant findings in the future.

Findings

12.12 Our findings are derived from work with the Departments of Finance and National Revenue-Taxation, income tax professionals, taxpayers and third party information providers. They are a synthesis of what we learned by examining information management for the four tax measures selected. Where appropriate, we illustrate our findings with examples from the specific measures.

Quantifying the Cost of the Information Burden

12.13 We found that the four tax measures included in the scope of the audit illustrated different aspects of the information burden. The new tax assisted retirement savings rules demonstrate the burden placed on corporations as third-party information providers. The Research and Development Investment Tax Credit demonstrates the burden placed on corporate tax filers and on the Department of National Revenue-Taxation. The Child Tax Credit and the Federal Sales Tax Credit demonstrate the impact on individual tax filers and on the Department of National Revenue-Taxation.

12.14 We confirmed that the information burden of certain tax measures is significant and worthy of consideration in the policy design process. For example we estimated, on the basis of the draft legislation, the costs of the new tax assisted retirement savings rules for employers that are sponsors of defined benefit pension plans, deferred profit sharing plans and money purchase pension plans. For all employers we estimate that the one-time cost of the new rules will be in the order of $330 million (1988 dollars). Approximately $170 million of this total represents the costs associated with the review and possible amendment of existing plans. Plan sponsors will consider it their responsibility to examine the likely effects of the new rules and to make such changes as necessary to protect the interests of plan members. A further $100 million of cost will relate to plan sponsors' efforts to communicate to plan members the impact of the new rules, to provide counselling to members and to respond to members' queries. The final component of the total is an amount of approximately $60 million for the set-up of systems to enable plan sponsors to report to the Department of National Revenue–Taxation additional information requirements established by the new rules. In addition to the one-time costs described above, plan sponsors will incur an annual cost of approximately $15 million to comply with the new reporting requirements.

12.15 The estimates given above for one-time costs consist of about 60 percent out-of-pocket costs and 40 percent imputed costs. In the case of annual costs the split is about 45 percent out-of-pocket costs and 55 percent imputed costs. Out-of-pocket costs represent items such as the purchase of consulting services. Imputed costs represent the management and employee time devoted by the plan sponsors themselves. We speculate that in most cases the work to which imputed costs relate will be undertaken by personnel who are now employed by the plan sponsor, rather than by personnel who will be newly hired for this purpose. Thus, in a certain sense, there is no incremental cost. Nevertheless, resources will be consumed that, without this change, would be otherwise employed. There is, therefore, a definite opportunity cost.

12.16 Exhibit 12.1 provides an illustration of the types of costs that both the plan sponsors and the Department of National Revenue-Taxation are likely to incur. Although mentioned in Exhibit 12.1, the estimates given above do not include any amount representing costs to be incurred by the Department of National Revenue-Taxation.

12.17 By their nature, estimates are based on assumptions. We believe that our assumptions are reasonable. We recognize that other assumptions could result in estimates that vary from ours. But, whatever these variations, the resulting estimates will confirm that the costs of the information burden are significant.

Exhibit 12.1

COST FRAMEWORK FOR THE NEW TAX ASSISTED RETIREMENT SAVINGS RULES

	Out-of-pocket Costs	Imputed Costs
COSTS INCURRED BY PLAN SPONSORS:		
One-time Costs		
Review of pension plan design		
Actuarial fees		
Management costs		
Employee communications		
Production of literature		
Consultation seminars		
Development of new systems and procedures		
System design		
System development		
Implementation and training		
Total One-time Costs (1)		
Recurring Costs		
Data gathering		
System operation		
Employee communications		
Reporting to Revenue Canada		
Total Recurring Costs		
Present value of Recurring Costs (discounted at X% per annum) (2)		
Total Lifetime Costs (1) + (2)		
COSTS INCURRED BY THE DEPARTMENT OF NATIONAL REVENUE – TAXATION:		
One-time Costs		
Design of new procedures		
Design of forms		
Development of systems		
Training of staff		
Development of literature to educate the public		
Total One-time Costs (3)		
Recurring Costs		
Data validation		
Data input		
System operation		
Production of forms		
Mailing to employees		
Consultation with employers		
Total Recurring Costs		
Present value of Recurring Costs (discounted at X% per annum) (4)		
Total Lifetime Costs (3) + (4)		

Note: Cost categories are for illustrative purposes only

12.18 We believe that the figures show the significance of the costs of these new rules, both in aggregate and for individual employers who will at least initially bear the costs for the benefit of their employees. This also illustrates that a significant portion of the income tax information burden may be borne by those who receive no direct benefit from the tax measure for which they are providing information, depending on their ability to pass these costs on to others.

12.19 Another example illustrating the significance of the information burden is the Research and Development Investment Tax Credit. We examined the costs incurred by small to medium sized corporations in supplying the information required to claim this tax credit. We estimate that for such companies the typical annual cost is about $2,500, while the typical one-time cost of implementing the systems and procedures to gather the required information is about $5,000. These costs are not solely attributable to the refundability feature, which was a modification made in 1985 to the Research and Development Investment Tax Credit that was in existence at that time. According to a small sample of companies we contacted, who typically claim a Research and Development Investment Tax Credit of several hundred thousand dollars, the information burden is not a disincentive to applying. However, the cost is still appreciable for companies of this size.

12.20 The Government estimated that the introduction of the refundability feature to the Research and Development Investment Tax Credit would create the need in the Department of National Revenue-Taxation for 50 additional person years, primarily devoted to the audit function.

12.21 For the Child Tax Credit and the Federal Sales Tax Credit, the impact of the information burden on the Department of National Revenue-Taxation was also significant. The Government estimated in 1978 that the Child Tax Credit would result in up to 400,000 more returns being filed, requiring 300 to 350 extra person-years. By 1986, roughly 535,000 individuals claiming the Child Tax Credit filed a tax return solely for this purpose. Of these, approximately 127,000 used an income tax preparation service, thus reducing their benefits by the cost of the service. A similar situation exists for the Federal Sales Tax Credit. The number of 1986 filers who filed a tax return just to obtain the Credit was slightly under 710,000. Almost 121,000 of these filers used an income tax preparation service. Given that about 16.3 million individuals filed tax returns for 1986, the impact of the above two measures on the Department of National Revenue-Taxation's workload was significant.

12.22 In the case of the Child Tax Credit, the "take-up" rate (the extent to which those eligible have taken advantage of the measure) has been estimated at 95 percent, suggesting that the information burden on the taxpayer is not a serious deterrent. In the case of the Federal Sales Tax Credit, the Department of Finance estimated that the take-up rate would be 90 to 95 percent, although no assessment of actual take-up has been performed.

12.23 The figures on the use of tax preparation services are interesting. On the one hand, the fees paid for these services represent a part of the cost of information burden. On the other hand, the proportion of returns filed solely to receive Child Tax Credit and Federal Sales Tax Credit that are done by tax preparation services (23.7 percent and 17 percent respectively) is lower than the proportion for the tax filing population as a whole (27 percent).

Finally, no doubt some clients of tax preparation services use these services for reasons that are unrelated to their ability to perform the task themselves. An example would be those who use tax preparers who also provide tax discounting services.

Consideration of the Information Burden in the Design of Tax Policy

12.24 At present there are a number of Government of Canada policies that require departments to give consideration to information burden. These include policies on regulatory burden promulgated by the Office of Privatization and Regulatory Affairs, the Paperwork Reduction Initiative of the Department of Regional Industrial Expansion, and the Treasury Board Policy on Government Information Collection and Public Opinion Research.

12.25 These policies contain general statements of principle on the management of information burden but do not provide detailed guidance that would be relevant to the Department of Finance in developing tax policy. Accordingly, our examination and assessment of the consideration of information burden was not performed to determine compliance with policy. It was to establish the extent to which information burden is considered, and whether all relevant factors are taken into account.

12.26 We examined documents reflecting the Department of Finance's approach to information burden in the design of the Research and Development Investment Tax Credit, the Child Tax Credit and the Federal Sales Tax Credit. The comments that follow reflect our focus on information burden and do not attempt to take into account all the considerations dealt with in the design of the policy or the choice of alternatives, as the case may be.

12.27 We found that some consideration was given to the potential information burden for each of these three tax measures. For example, there was evidence that the Department of Finance took into account the following for the Child Tax Credit:

- the impact that different designs for the measure would have on the Department of National Revenue-Taxation in terms of the number of additional returns that would be filed and the number of additional staff that would be required;

- the fact that the measure would result in some additional use of tax discounting services; and

- that affected taxpayers would have to supply additional information to claim the credit.

12.28 In 1986 the Government introduced the advance payment feature of the Child Tax Credit to provide more timely assistance to low-income families and to reduce the need for tax discounting. Prior to its implementation, the Department of Finance considered the following factors:

- the effect of different delivery mechanisms on the use of discounting services;

- the effect of different delivery mechanisms on the staff requirements in the Department of National Revenue-Taxation and other departments; and
- the cost of materials involved in payment of the benefit more frequently on separate cheques compared with combining the payment with an existing expenditure program.

12.29 Examples of factors that the Department of Finance took into consideration for the Federal Sales Tax Credit included:

- how different approaches to the definition of "income" for the measure would affect the complexity both for the taxpayer and the Department of National Revenue-Taxation;
- the cost of a single lump sum payment compared with that of several payments during the year; and
- the use of tax discounters.

12.30 For the Research and Development Investment Tax Credit, the Department of Finance considered:

- the estimated number of taxpayers that would apply for the credit and the number of additional person years that would be required by the Department of National Revenue-Taxation to process the workload;
- the need to use scientific experts to validate the claims for the credit; and
- forms design.

12.31 The assessments of information burden that we saw were in a variety of formats and included a variety of factors. Even for measures that embodied similar concepts, the way information burden was considered and the specific factors taken into account differed. While the evidence shows that information burden was considered in the policy design process, we noted that this was sometimes done only in a qualitative manner. We believe it would have been feasible to make a quantitative estimate of the impact. For example, it would have been possible to estimate for the Child Tax Credit as it was originally designed, and for the Federal Sales Tax Credit, the reduction of benefits expected to result from using tax discounters. Estimates of other costs, such as the required additional computer capacity, the cost of issuing additional cheques or the cost of developing and printing new forms, were not evident in all cases.

12.32 Even though each proposed measure will be unique in terms of its specific information demands, it would be appropriate to have a consistent overall approach to considering the information burden that sets out for each viable design alternative:

- a qualitative assessment of the impact of the additional complexity on compliance by the taxpayer;

- a quantified assessment of the incremental costs to the taxpayer of complying with the measure, including any reduction in benefits that might result from the complexity of the design;
- a quantified assessment of the impact, including cost, of the measure on third party information providers;
- a quantified assessment of the Government's costs of implementing and administering the measure; and
- an overall evaluation of the costs of the measure in relation to its benefits or effects, as the case may be.

Consultation with Those Who Bear the Information Burden

12.33 In view of the fact that the information burden of new income tax measures can affect a variety of groups or individuals in different ways, we assessed the extent to which those affected are made aware of the potential information burden before legislation is passed.

12.34 In discussions with those affected by the new tax assisted retirement savings rules and the Research and Development Investment Tax Credit, we learned that industry associations representing specific affected groups usually become aware of the potential information burden of tax measures before the measures are finalized. In the case of the new retirement savings rules, this has been illustrated by the changing of the rules more than once to simplify compliance. The new policy was first exposed to the public in February 1984. It was subsequently changed several times: in May 1985, October 1986, and again in March 1988, when the draft legislation was released. The changes included a number of adjustments to make the policy administratively more feasible. These represent an important example of improvement as a result of consultation.

12.35 The Department of National Revenue-Taxation produced a very thorough booklet describing the calculations required under the new tax assisted retirement savings rules. The booklet was detailed enough to enable an employer to understand the nature and extent of information the new rules would require it to provide.

12.36 The Government's establishment of the Office of Privatization and Regulatory Affairs (OPRA) in 1986 is indicative of a heightened awareness of the impact of regulations on Canadian citizens. A Citizen's Code of Regulatory Fairness has been developed, which is an essential element of the Government's Regulatory Reform Strategy. The principles embodied in the Code are intended to ensure openness, fairness, efficiency and accountability in all regulatory activities. Among the principles guiding the implementation of the Regulatory Reform Strategy is ensuring that businesses of different sizes are not burdened disproportionately by the imposition of regulatory requirements. This principle encompasses the potential impact of paper requirements in any proposed regulation. The Strategy allows information providers to have input into proposed new regulations, including tax measures, that will create an additional information (or paper) burden on them.

12.37 A specific mechanism introduced by OPRA is the annual Federal Regulatory Plan, which requires departments to identify and describe proposed regulatory initiatives for the upcoming year. We reviewed the Department of Finance's assessment of the impact of the new tax assisted retirement savings rules which appeared in the 1988 Plan. The anticipated impact of these new rules is described in a brief paragraph as follows:

> These regulations are strictly consequential to the tabling of the pension reform legislation. They are purely technical in nature in that they provide for the manner in which all individuals are to calculate their annual RRSP contribution room. The whole pension reform proposals are intended to address the current inequities that exist in the amount of tax assistance taxpayers are receiving in their savings for retirement. The whole pension reform goal is to provide equal tax assistance for all taxpayers regardless of the type of retirement savings plan they contribute to.

12.38 In light of our own research into the information burden imposed by the new rules, we consider that this statement could have included a more complete depiction of impact. For example, it could have noted that the bulk of the information burden will fall initially on employers. Description and estimates of the kinds of costs that will be incurred in complying with new measures, such as we have depicted in Exhibit 12.1, would give readers a better sense of how they will be affected.

12.39 We have been advised by OPRA that the information in the Regulatory Plan is intended to be concise, therefore a high level of detail is not required. OPRA has indicated that detailed information would be more appropriate to the Regulatory Impact Analysis Statement that is submitted to OPRA with a draft regulation at the initial review and pre-publication stage.

12.40 Another such initiative, the Paperwork Reduction Initiative, was announced by the Minister of State for Small Businesses and Tourism in May 1987. It states that "departments and agencies which impose paperwork will prepare paperwork reduction plans which will be approved by Cabinet and then monitored." The Department of National Revenue-Taxation is a participant in this program. We noted that a summary of its 1987-88 paper burden reduction activities included measures to simplify the administration of the Research and Development Investment Tax Credit. In addition, further administrative changes were announced by the Minister of Finance in April 1988 that are aimed at expediting refunds.

12.41 In summary, while the Department of Finance does conduct consultations, and while there are government initiatives directed to managing regulatory and paper burden, further improvements are possible in the mechanisms for making those affected by proposed new income tax measures aware of the consequent information burden. In the design of such improvements, recognition would have to be given to the need for strict secrecy in the development of new tax law. Accordingly it might be necessary to tailor the general mechanisms used to manage information burden in government to the special circumstances of the Department of Finance.

Evaluation of Information Impacts

12.42 Our 1986 Report chapter on income tax expenditures noted that, at that time, no program evaluation function independent of line management existed in the Department of Finance. Since then, the Department has created the Tax Measures Evaluation Division. We understand that the work of this group will include consideration of information burden.

12.43 Our 1986 Report also noted the Department's practice of performing reviews in the course of modifying existing policies and tax measures. The analysis prepared by the Department before adding the advance payment feature to the Child Tax Credit is an example of this. As we noted earlier, consideration of information burden was evident in this analysis.

Summary

12.44 There are significant costs associated with the information burden resulting from compliance with our income tax system. It is apparent that the designers of tax policy are aware of these costs. However, we believe information burden could have received consideration on a more systematic basis when the tax measures we examined were designed.

12.45 The Government as a whole has made some important strides in making more visible the impact of regulations, in particular the "paper burden" that regulations create. However, even with the recent increase in sensitivity to information burden, major new burdens, such as that arising from the introduction of the tax assisted retirement savings rules, are still being added without much public disclosure of the cost implications. We believe that fuller disclosure of the potential information burden to be created by each new tax measure would enhance the effectiveness of the information provided by the Department of Finance in its own publications and through its contributions to the publications of the Office of Privatization and Regulatory Affairs.

Department's Response

The Department of Finance shares the views of the Office of the Auditor General that costs associated with the provision of income tax information must be explicitly recognized and that government policy should be designed in such a manner as to minimize the information burden placed on taxpayers and on the government itself. Appropriate consideration of information costs associated with tax measures – their compliance and administrative costs – is necessary if the tax system is to be economic and efficient.

In considering the analysis by the Office of the Auditor General of the information costs of tax measures, three major areas deserve comment. They are the relationship between information costs and other objectives which contribute to the ultimate design of tax measures; the methodology used by the Office of the Auditor General to estimate the compliance costs of the proposed legislation for tax-assisted retirement saving; and the process by which these information costs are made public and the related process for incorporating public comments.

Information Costs and Other Objectives

The tax system is often used to support the policy objectives of equity and efficiency. The measures studied in this report are of this nature. The refundable sales and child tax credits support the distributional objective of reducing the total tax burden on lower income families; the refundable R&D tax credit supports the economic efficiency objective of encouraging smaller firms which often have restricted access to capital to undertake R&D; and tax incentives promote retirement saving plans to which employers and employees contribute. Achievement of these objectives implies some administrative costs for government and some compliance cost for taxpayers. But the objective of the government is to design measures in such a way as to keep these costs as low as possible.

The priority attached to this goal was formally noted in the objectives for Tax Reform set out in the 1987 White Paper. Its importance is also indicated by the fact that Revenue Canada, which has the responsibility for administering the tax system, is consulted on ways to minimize information costs for all major tax proposals.

Parliament also assigns considerable importance to the compliance and administrative costs of tax proposals. The public record indicates substantial attention to these costs in Parliamentary debates and Committee hearings for all legislation considered in this Report.

An illustration of this process is appropriate. The compliance and administrative costs of the child tax credit were a matter of substantial concern before the introduction of this measure in 1978. Considerable attention was devoted to simplifying the required form, an extensive advertising campaign was undertaken to publicize the new procedure, and Revenue Canada made arrangements to process the credit without a completed tax return if the recipient supplied some basic information. Compliance and administrative aspects of this new credit were carefully worked out by the government and carefully considered by Parliament.

There has been continued attention to compliance costs for this credit since its introduction. For instance, compliance costs were further reduced by the introduction of advance payments for the credit in 1986. The credit was again re-examined and compliance costs reconsidered in preparation of the White Paper on Tax Reform of 1987, in the Reports of Parliamentary Committees studying the White Paper and in the Minister of Finance's response to these Committee Reports.

Methodology in Estimating Compliance Costs for Tax Assisted Retirement Saving

The objectives of the proposed revisions to the tax provisions to assist retirement savings are: to improve the fairness of the system by assuring all taxpayers equal access to the system; to provide better service to the taxpayer through a seven year carry forward of unused contribution room; and to ensure that misuse or abuse of these provisions is reduced in order to control the amounts of revenue forgone. The information costs – both one-time and ongoing – must be considered in relation to these objectives and in the context of the very large amounts of revenue forgone by governments to provide this tax assistance, currently eight to nine billion dollars annually. In this context neither the one-time cost for set up of systems nor the $15 million per year ongoing costs for compliance appear excessive in relation to the *objectives of the legislation and the amounts of revenue involved. The ongoing costs amount to a small fraction of 1 per cent of the revenues forgone by governments.*

We believe that the overall estimate of $330 million for non-recurring costs suggested by the Office of the Auditor General significantly over-estimates the extent to which changes will be made to existing pension plans as a result of the enactment of new tax legislation. Where changes are made, they will often be made for reasons of tax effectiveness rather than compliance. We do not consider it appropriate for such tax planning costs to be classed as costs of compliance with the tax regulations. In addition, we conclude that the study has not separated the costs of incremental changes to comply with the tax rules from costs associated with the regular review and amendment of pension arrangements that would take place in the absence of legislative change. Finally, we question the study's estimate of the volume of services to be provided by pension consultants – services which constitute most of the estimated out-of-pocket expenses of $200 million. The total amount billed for all pension-related work by firms in the pension consulting industry is currently of the order of $100 million per year. Taking these various points into account could produce estimates of one-time costs that are only one-fifth as high as those suggested in the study prepared for the Auditor General.

The study emphasizes that the compliance costs of the retirement savings tax measures are borne by employers as "third party" providers of information. This characterization fails to recognize the importance of fair and equitable pension arrangements to employers as well as to their employees.

Process

Finally, it should be noted that the Office of the Auditor General's estimates of compliance costs are based on a discussion draft of proposed legislation released in March, 1988. The legislation is still in the process of development and, as the chapter says in paragraph 12.34, the necessary and important process of consultation is still ongoing. This process is briefly described below.

Where major changes in tax structure are proposed by the government, the process usually begins with the release of a discussion paper. Draft legislation is then developed and released with the objective of obtaining comments on feasibility and desirability from the tax community, the public, and sometimes from Parliamentary Committees. After the legislation is tabled in Parliament, it is examined by Parliamentary Committees which have been given increased powers for this purpose by the government. Widespread consultation with affected groups may again take place during the Parliamentary process. This consultative process has been followed in development of every Budget since 1984, in Tax Reform and in all current major initiatives such as that for reform of tax-assisted retirement saving.

In the present case of legislation for tax-assisted retirement saving, draft legislation was relased for comment in March 1988. In a Press Release of August 19, 1988, the Minister of Finance indicated that he was deferring this legislation for a year to incorporate comments and suggestions received after March in the consultative process. It is unfortunate that this development is not acknowledged in the study by the Office of the Auditor General.

DEPARTMENT OF FISHERIES AND OCEANS
ATLANTIC OPERATIONS, INSPECTION AND CORPORATE FUNCTIONS

DEPARTMENT OF FISHERIES AND OCEANS
ATLANTIC OPERATIONS, INSPECTION AND CORPORATE FUNCTIONS

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DEPARTMENT OF FISHERIES AND OCEANS ATLANTIC OPERATIONS, INSPECTION AND CORPORATE FUNCTIONS

Main Points

The Atlantic fisheries produce over $2.3 billion in products, export $1.9 billion, and give direct employment to over 100,000 people. The Department's mandate involves it directly in most aspects of this industry, including resource management (husbanding the resource and managing the harvest) and fish inspection (inspecting the handling, processing and storage of the product). The Department has a strong reputation internationally for both of these programs. (paragraph 13.17)

We found that the procedures used to set the annual fishing plans were reasonable. However, there is a need for improved economic analysis relating to long-term fleet viability. The long-term strategies for specific fleets and fisheries should consider the associated enforcement costs. Further, technological change and past practices have made it difficult for the Department to control fully the fishing capacity of boats used in the fishery. (13.29 to 13.52)

Problems were found in the acquisition of some capital items used in fisheries enforcement. (13.61 to 13.88) The productivity of crews on inshore patrol boats could be increased. (13.75 to 13.78)

Procedures to inspect fish products for health and safety defects were adequately controlled. However, weaknesses in management practices and controls have led to inconsistencies in the inspection practices for quality and sensory defects. (13.89 to 13.118)

The Pacific region has made progress in addressing the recommendations from our 1986 Report. Some areas require continued attention. (13.167)

Management has been aware of most of these problems, often for many years. Action has often been diverted by crises in the industry. One of the major challenges faced by departmental management will be to continue to marshall the resources and sustained will to see the solution of these problems through to a successful conclusion. (13.20)

DEPARTMENT OF FISHERIES AND OCEANS
ATLANTIC OPERATIONS, INSPECTION AND CORPORATE FUNCTIONS

Introduction

The Atlantic Fisheries

13.1 Canada is the world's largest exporter of fish products. In 1987 this trade led to exports valued at just over $2.7 billion. The Atlantic fisheries account for over 70 percent of this ($1.9 billion), of which three-quarters goes to the United States. A relatively labour-intensive industry, it is a significant, or often the sole, source of employment throughout the region. Departmental data show that in 1986 there were 28,000 full-time and 32,000 part-time fishermen in the Atlantic Zone. Together they run a fleet of nearly 29,000 registered boats, 83 percent of which are under 40 feet in length. Such boats would usually be crewed by one person and a helper.

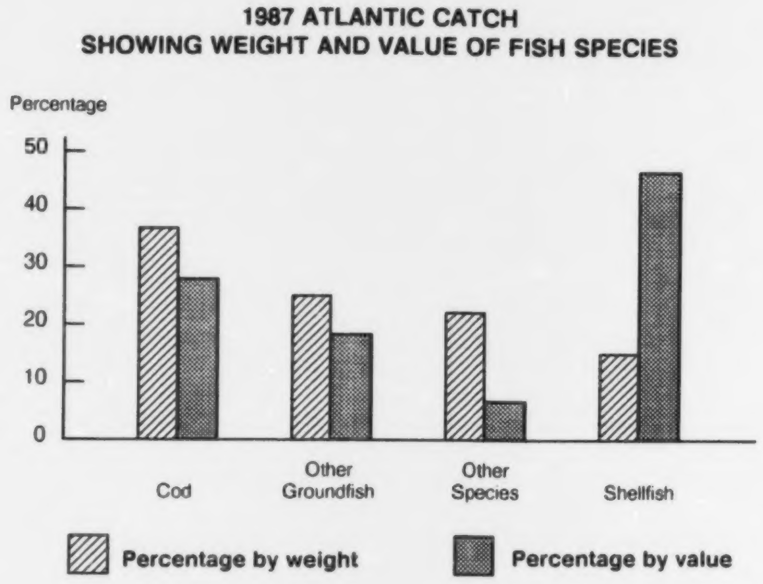
13.2 The Atlantic fisheries also provide significant employment in the processing sector. Departmental data show that in 1983 there were just over 600 plants (up to 800 in 1986) processing fish in Atlantic Canada, employing over 60,000 persons. For both the harvesting and processing sectors, most of the activity is widely scattered over the small ports and villages that dot the Atlantic and Gulf coasts and carried on in small dispersed operations. Together, the harvesting and processing sectors of the Atlantic fishery provide employment for over 100,000 persons. For most of these people the work is seasonal; however, working practices in both sectors ensure that most get enough "stamps" to qualify for unemployment insurance payments during the off season.

13.3 The fisheries themselves are diverse. Exhibit 13.1 shows the landed weight and value of catches for 1987 for the major groupings of species fished in Atlantic Canada. The largest catches are of groundfish, principally cod, which is the most labour-intensive, and in many ways the most visible, fishery in the area. Shellfish, principally lobster, scallops and crab, are fisheries with much lower tonnages but much higher values. These are also much more locally concentrated and involve fewer people. Because of the pervasiveness of the groundfish fishery in Atlantic Canada, we have turned to it more often than the others for examples.

The Department in Atlantic Canada

13.4 To meet its responsibilities in Atlantic Canada, the Department has established four regions: Quebec, Gulf, Scotia-Fundy and Newfoundland. The four regions have a combined staff of 3,156 and operational budgets for 1987-88 of $230 million. Each is headed by a Regional Director General and is a smaller version of the Department, delivering the full range of departmental programs. Each is at the same time unique, as program delivery is adapted to suit the nature of the fisheries and the region.

Exhibit 13.1



13.5 **Resource management**. The primary task of the Department is to conserve Canada's marine resources and to manage them in a way which best serves the economic interests of those who make their living from them. In doing so it performs a direct hands-on role, making decisions that have an immediate impact on the lives and incomes of those working in the fishery. This management of the fishery requires a base of scientific advice ("How big is the pie?") and socio-economic advice ("What are the impacts of different ways of cutting it?"). There are, however, no "natural" or scientific rules which determine how the pie should be divided. Accordingly, the Department must not only provide the best scientific and economic advice to the Minister, but must ensure that this advice is subjected to broad scrutiny, so that the immediate and long-term effects of suggested actions on the various stakeholders are as fully understood as possible. The decisions which have to be made are ultimately ministerial judgments.

13.6 **Fish inspection**. The Department views its role, under federal legislation, as providing reasonable assurance that the fishing industry meets its responsibility to maintain compliance with minimum standards to ensure the quality and safety of fish products for human consumption that are traded inter-provincially, imported or exported. This inspection includes three components: registration of plants and vessels based on their conformity to standards for construction; operational inspections to assess the degree to which plants, vessels and other facilities are operated in accordance with quality and health criteria; and inspection of raw material and the final product to ensure its conformity with health, safety and quality standards. Fish Inspectors are often a regular presence in the processing plants while they are in operation. The result is that, in many ways, the Department is as directly linked to the processing sector as it is to the harvesting sector of the industry.

The Department's Challenges and Constraints

13.7 **Common property resource**. The overriding difficulty in managing any fishery is the common property nature of the resource. The Department has custody of this resource and must manage it for the benefit of all. In timber rights or mineral rights, the right to harvest can be explicitly attached to physical objects or geographical areas and these can be allocated in an explicit manner to individuals; i.e. the trees in this area belong to X to harvest. With fish this is not possible. Accordingly, managing this type of resource is heavily dependent on regulating the amount to be caught and the nature and level of effort to be spent catching. This is done through a comprehensive process, involving scientific, industry and provincial input, to advise the Minister on the setting of quotas. Where quotas are in effect for a group of fishermen or boats, the most rational course for each member of the group is to invest as much money as possible in efficient catching equipment and to use that equipment to catch as much of the quota as possible, as quickly as possible. Unfortunately, the pursuit of individual rationality has had the collective result, in virtually every fishery, of persistent overcapacity and the economic uncertainties that accompany it.

13.8 **Overcapacity**. The basic and most pervasive problem with the Atlantic fisheries is that there continues to be too much capacity, both in boats and plants, to sustain reasonable returns for most involved. The Department has taken several measures to address this problem, including the increasing use of Enterprise Allocations for most offshore fisheries (including shellfish) and reductions in licences in some other fisheries. These significant structural changes have reduced, but by no means eliminated, the capacity problem. In the offshore, Enterprise Allocations have encouraged rationalization of capacity down toward the level of resource available. Very high profits from extremely favourable market conditions and lower interest rates have reduced the financial effects of the under-utilization of the capacity of the capital assets in this sector. In the inshore fisheries, for groundfish in particular, the financial pressures of continuing overcapacity have been ameliorated by a combination of favorable commercial circumstances and an unemployment insurance program that supplements earnings from the fishery.

13.9 **Recent history**. A period of particular turbulence for the Atlantic fisheries began in 1977 with the declaration of the 200-mile fishing zone for Canada's coastal waters. Although key stocks were declining, the declaration was accompanied by a wave of optimism and highly leveraged capital investment in both fishing vessels and processing plants. By 1981 this over-investment, high inventories of fish (some of poor quality) and reduced catches, combined with rapidly rising interest rates, created an acute cash flow crisis in Atlantic Canada's fishing industry. Massive government intervention prevented widespread bankruptcies, higher unemployment and grave economic hardship for the region. As part of its response to this crisis, the federal government set up the Task Force on the Atlantic Fisheries (known as the Kirby Task Force) in 1982 to examine "how to achieve and maintain a viable Atlantic fishing industry, with due consideration for the overall economic and social development of the Atlantic provinces." As the most recent of many studies, the Kirby Task Force recommendations are the agenda that drives the Department's actions in the region, except for its recommendations on marketing.

13.10 Over the last three years the combination of a low value for the Canadian dollar relative to the U.S. dollar, the near collapse of the fisheries of our major competitors, and a sharp rise in the demand for fish, have brought a period of unprecedented prosperity. This is a situation that is unlikely to hold up in the long term. Already the Canadian dollar has strengthened against the U.S. dollar to the point that profits are affected, prices and demand are in a gradual decline, and the recovery of some of our competitors' fisheries has seen them beginning to take back a share of the premium fish market. Trade publications suggest that the inventories of Canadian processors are rising rapidly. In short, despite the current prosperity, some of the structural problems of the industry described by the Kirby Task Force as leading to overcapacity and over-capitalization persist, particularly in the inshore fisheries and the processing sector.

13.11 **Fish inspection program.** Following the publicity surrounding the tuna and mussel problems, the fish inspection program has had to function in an environment of increasing public and industry scrutiny. The complexity of fish inspection is increasing due to technological change and, in the Department's view, an increased public and political expectation of "zero risk". To deal with this, the Department uses a multifaceted approach in which fish may be inspected at all points in the harvesting, transportation and processing chain. The emphasis is on encouraging processors to "produce out" defects rather than have them "inspected out". The major challenge will be to encourage processors to take more responsibility for product quality through their own quality control rather than relying on the Department.

13.12 **Atmosphere.** The widely dispersed and often remote fishing communities of Atlantic Canada, and the need for day to day management of the fishery, require an ongoing, almost daily, contact between the representatives of the Department and those whom they serve. It produces an intimacy of the cause and effect of policy that is very unusual in the federal environment. One result of this is that the problems of the fishery are translated very directly, and sometimes dramatically, to the Department. There are no barriers such as other departments, or levels of government, or even the usual distance between the client and Ottawa, to mediate. Consequently, those managing the fishery feel that they are constantly moving from one serious problem or crisis to another. Further, as fishermen and plant owners often see the solution to their problems as access to more fish than the current fishing plan allows, either by overfishing their quota or by taking part of the quota from another fleet, an element of conflict is often involved.

13.13 Despite the air of crisis management and the frequent confrontations and conflicts, we found that the Department has a cadre of men and women who demonstrate that they are highly committed to serving the fishery and the people who work in it. The many we interviewed and observed showed that they are prepared to put in long hard hours, often in difficult conditions, to make the fishery work.

Scope

13.14 The focus of our audit was on the Department's two major programs, Resource Management and Fish Inspection. Because of the broad nature of many scientific management concerns, and a major internal study of the Hydrography program, we scoped out all science program issues not related to resource management. As major changes were taking place in the area of habitat management, and Cabinet decisions on the Department's responsibility for ocean science were pending, we did not audit these areas.

13.15 We did audit two support programs for the fishing industry: the Fishing Vessel Insurance Program; and the various projects under the umbrella of the Economic Regional Development Agreements. Our findings on the latter are reported as audit notes in Chapter 3 beginning at paragraph 3.36.

13.16 We also audited the Department's 1987-88 and 1988-89 Part III of the Estimates, as reported in Chapter 5 on Information for Parliament.

Summary Observations

13.17 While much of the remainder of this chapter will be devoted to a discussion of problems in the Department's management and inspection of the fishery, we emphasize that these exist in the context of the Department's world-wide reputation, both for its fisheries management activities and for its inspection program – a reputation that it is important for the Department to maintain.

13.18 Underlying many of the problems discussed in this chapter is the fact that, through successive budget cuts over the last 10 years, the Department has tended to focus on maintaining its levels of service to the fishery, or indeed on increasing them. Over the last four fiscal years the resources devoted to inspection and enforcement have remained effectively constant. In the face of rising demands from the fishery, the squeeze on resources has tended to have its most significant impact on program support and training, resulting in serious deficiencies in these areas. The Department has attempted to alleviate these problems by consolidating operations to reduce overheads and make effective resource reallocations possible. However, given the extent of the problems, the lack of resources, both human and financial, that can be freed from the line work of the Department to deal with them, and the disruptions to this work that are bound to arise due to future crises, it is unlikely that corrective action will be accomplished quickly.

13.19 Whether it be in the area of resource management or inspection, much of the ability to produce and sustain a high level of performance depends on having appropriately qualified and trained personnel. The national training program for Fishery Officers provides a systematic curriculum for full-time Officers. However, the majority of Officers are permanent seasonal workers and have not had this training made available to them. Nonetheless, they are expected to carry out the same duties as full-time Officers, relying primarily on very limited local training. As noted later, we found significant deficiencies in the training for Inspectors, including a lack of programs to meet acknowledged training needs. In some areas, specific training needs have not been identified. The resolution of many of the problems we have identified in this chapter will require significant staff training.

13.20 As we have observed throughout the chapter, many of the problems are long-standing. We observed on them in 1977 and in our 1981 Department-wide audit, in our follow-up of that audit, and in our 1986 chapter on the Pacific fishery. We have often found evidence of plans and initiatives to deal with them. Some have been recently started and show encouraging progress. Others were started and then abandoned or postponed, usually in the face of other events. One of the major challenges facing departmental management will be to continue to marshall the resources and will required to see the solution of these problems through to a successful conclusion.

Resource Management

13.21 Canada's Atlantic fisheries are an industry beset with complex problems. They are not unique to fishing in Canada, and, in greater or lesser measure, are problems common to all the major fisheries in the world. In the past these problems have often been summarized by the phrase "too many fishermen, too few fish". Currently the Department believes that, for most major species, stocks are at or near their optimum levels, but that a tendency to excessive capacity and over-capitalization remains. In a common property resource, this fundamental weakness is compounded by the normal boom-bust cycle inherent in all natural resource industries. Over the last decade, Canada has shown signs of being able to break out of this cycle through the imposition of a very strict management regime based on scientific advice.

13.22 The following description of resource management, based on "Total Allowable Catches" (TACs) and quotas, applies primarily to groundfish, such as cod, redfish, flounder and halibut, the highest volume fishery in the Atlantic. Shellfish, pelagic (such as herring, mackerel and capelin) and anadromous (primarily salmon) species are managed through a combination of measures including quotas, size limits, trap limits, seasons and area restrictions. However, the same processes of scientific advice and industry consultation are used to arrive at the management plans for these other species as are used for groundfish.

13.23 The Department has established a structure of TACs to rebuild fish stocks steadily and gradually, with the objective of optimizing the average yield in the medium to long term. Stability of supply, and of the fishery, has become a major objective. The basis of this management scheme is the scientific estimation of the TAC for each stock. Data from a variety of sources are used to estimate the mass of fish that each stock can deliver in the long term: "the maximum sustainable yield". For virtually all stocks except shellfish, the TAC is set at a value (called in technical terms F0.1) which is somewhat lower than this. This lower value allows for the gradual growth of the stock, the economic use of fishing resources, and to some extent provides a cushion against either over-fishing or over-estimation of the TAC.

13.24 The fisheries management regime must also fairly share the access to the fishery by all participants. Were the fishery to be fully open, the large and relatively efficient offshore, midshore, and components of the mobile inshore fleets could quickly catch the entire TAC for most stocks at the expense of the numerous individual inshore fishermen. Within the social structure of Atlantic Canada such a situation would not be tolerable, nor would it produce a good fishery; for example, many plants would be unable to process the resulting glut of fish rapidly enough. In an attempt to make the process fairer, the TACs are broken down into quotas, with each quota assigned to a different sector of the fleet.

13.25 The fundamental basis of quota allocation is a division of the fleets into an inshore and offshore sector. The inshore's segment of the TAC is divided into quotas based on "gear-type", which includes boat size and equipment type. Within a gear-type, each boat tries to catch as many fish as it can before the total catch for that gear-type reaches the quota. Accordingly, the division into gear-types is done in a way that tries to divide the fleet into groupings that compete for their share of the stock on a roughly equal basis. Other measures such as trip limits and seasonal quotas are also being used. As technology can change the relative competitiveness of different types of vessels and gear, it is necessary to review these breakdowns regularly. For example, technological advances have allowed the construction of trawlers in the 45-to 64-foot class that are very efficient fish hunters and are fully capable of fishing out to the 200-mile line. Currently they are classified with the less mobile inshore fleet which is more multi-purpose, where some believe they compete unfairly with it for the quotas.

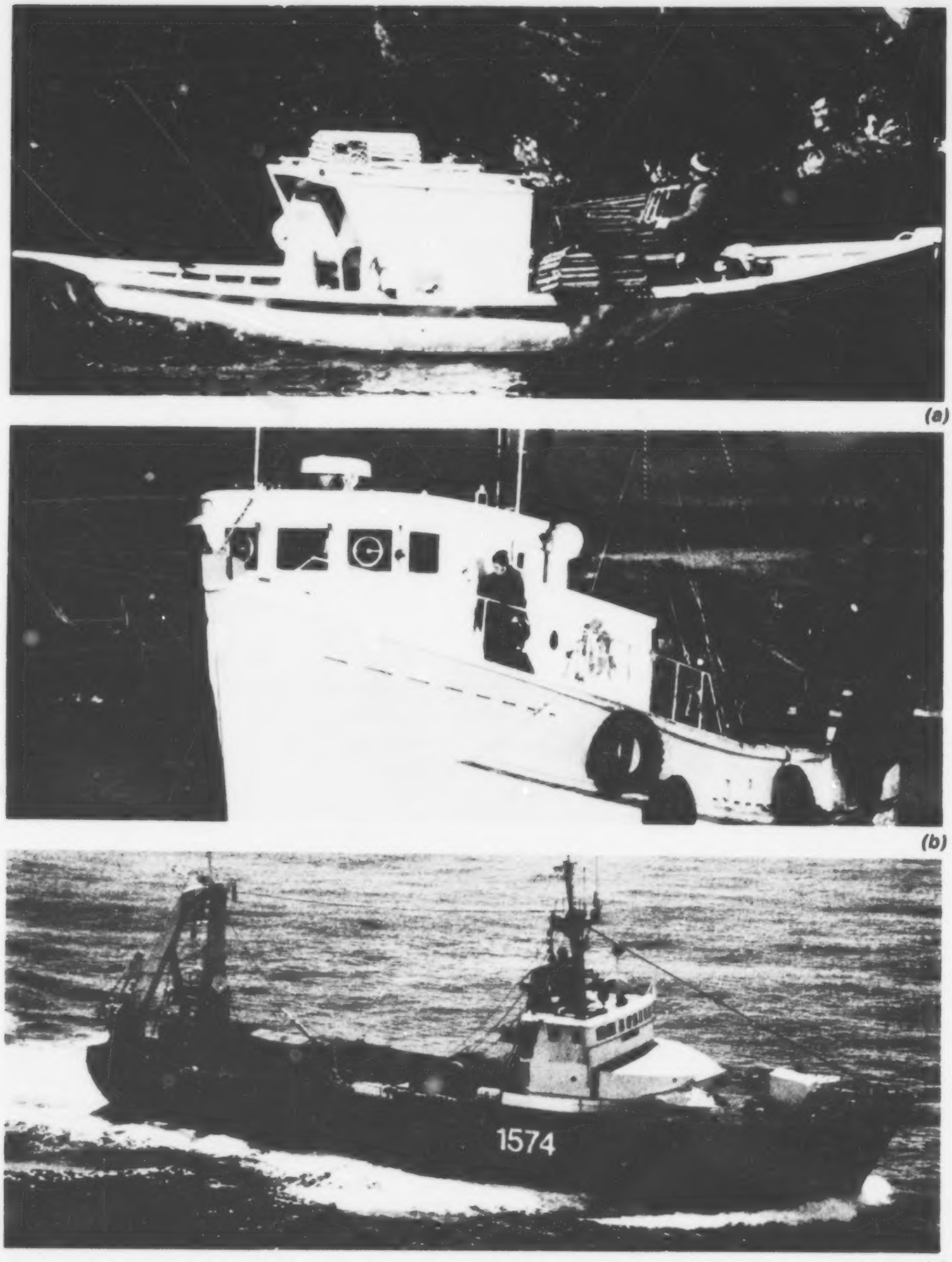
13.26 The majority of the offshore vessels (see photo) are owned by either Fisheries Products International of Newfoundland or National Sea Products of Nova Scotia, but there are also 13 independent owners in the offshore fleet. This fleet's quota within the TAC is divided among the owners in the form of "Enterprise Allocations". These constitute the owners' prerogative to fish stock up to a specified tonnage. This non-competitive allocation of the resource has allowed for stabilization of this sector of the industry. Long-term planning is now possible for the owners, and harvesting can be spread over the whole season, allowing for both fleet and plant rationalization. Also, fish are not taken until they are needed, which in general allows for better quality and better conservation of the resource.

13.27 The apparent success of this program has resulted in Enterprise Allocations being introduced for offshore lobster and scallops, northern shrimp, groundfish vessels in the 65-foot to 100-foot range, and to some parts of the inshore fleet. There are costs associated with increased enforcement related to Enterprise Allocations. For example, in 1987-88 the Department estimates that the domestic offshore observer program, which is only one element of enforcement, cost nearly $3 million, a cost primarily related to Enterprise Allocations. The Department believes these costs may be offset by increased economic benefits to the industry, or recovered through direct billing to the enterprises. It has begun an evaluation of the Enterprise Allocation program which includes a review of the level of access fees and alternative approaches to enforcement. This review is to be completed in late 1988.

13.28 TACs and quotas, along with licensing and vessel registration to control access to the fishery and fishing effort, represent the basis of the legal and regulatory regime used to manage the fishery. In addition to setting the rules for the prosecution of the Atlantic fisheries, the Department is also responsible for enforcing them to ensure that stocks are not over-fished and that only those licensed to do so engage in the fisheries.

Resource Allocation

13.29 The resource allocation process is an annual attempt to answer, more or less in sequence, three questions. How many fish are there? How many of these can be caught and still allow for a stable or growing fish population? How will the portion to be caught be allocated between the offshore and inshore and amongst the gear types?



Canada's Atlantic waters are fished by a diverse fleet; from traditional boats (a), through powerful midshore draggers (b), to modern offshore trawlers (c) (see paragraph 13.25 and 13.26).

13.30 The product of this process is a fishing plan for each major species or complex of stocks, issued annually by the Minister. The Department's role is to establish a process for giving the Minister the best biological and economic advice it can provide, with the fullest assessment of the reactions of the industry and provinces through an extensive consultation process, and allowing for consideration of the social and political impacts of decisions.

13.31 Atlantic resource allocation activities in the regions and in headquarters, including the scientific assessment and advice process, account for over $50 million in budgeted salary and operations and maintenance costs.

13.32 The Department follows an annual resource allocation cycle, depicted in Exhibit 13.2. Scientific advice is developed on the various stocks. The Canadian Atlantic Fisheries Scientific Advisory Committee (CAFSAC) provides a review and challenge of that advice designed to ensure that it is as good and stable as the state of the art in stock assessment will allow it to be. Estimating the number, age and size of the fish in the sea is a difficult task, and the estimates have relatively large and inescapable error bands. We are concerned that the scientific community has not always been successful in making resource managers and industry aware of the process behind developing these estimates and of the estimates' inherent limitations.

13.33 The scientific advice is then issued by CAFSAC to those responsible for resource management and used as the basis for developing draft fishing plans. These form the basis for a consultation process open to all those involved in the fishery, and to the public. It begins at the regional level and culminates in ministerial consultations with the provincial fisheries ministers. The Minister then makes his decision and the plan is issued.

13.34 Based on our examination of this process, including related scientific activities, we are satisfied that the Department is following a reasonable and open approach to the establishment of quotas and one that is generally viewed as being legitimate and fair by those involved in the process. Canada has a good reputation for its management of stocks in the Atlantic, with most stocks either rebuilding or stable, and the fishing industry experiencing significant growth. The stock assessment process contains controls designed to ensure that the scientific advice on fish stocks is both consistent from year to year and reliable.

13.35 **Enforcement implications.** To satisfy the demands of numerous components of the fishing industry that compete for the same resource, and to deal with an overcapacity situation that exerts excess pressure on stocks, the Department has increasingly been dividing TACs and quotas into smaller portions. Many people refer to this continuous fine-tuning as "micro-management". Exhibit 13.3 shows the number of divisions of a single TAC that can occur for Atlantic cod stocks.

13.36 The micro-management principle is part of a long-term process to divide the management of stocks into more discrete, controllable units. The enforcement concerns and costs regarding this strategy have not been quantified; however, the Department intends to assess them as they become known and to attempt to address any issues accordingly. Most changes in management plans or procedures have been introduced on a limited or pilot basis.

Exhibit 13.2

ANNUAL RESOURCE ALLOCATION PROCESS FOR ATLANTIC GROUNDFISH STOCKS

January	Current year management plan goes into effect with fisheries openings as stipulated in the plan.
February **March**	Scientists conduct spring research surveys and biological stock assessments.
April	Canadian Atlantic Fisheries Scientific Advisory Committee (CAFSAC) sub-committees meet to review scientific stock assessments.
May	CAFSAC Steering Committee meets and provides scientific advice for most stocks.
June **July**	Atlantic Groundfish Advisory Committee meets to review CAFSAC advice and provide initial industry input to the management plan.
August	Regional Groundfish Advisory Committees meet to discuss scientific advice and management measures.
September	Research survey and stock assessments continue. CAFSAC meets to review fall surveys and assessments and provide advice.
October	Fall meeting of the Atlantic Groundfish Advisory Committee to review fall CAFSAC advice and provide further industry input.
	Department prepares draft management plan.
November	Meetings of federal and provincial ministers and deputy ministers to review draft plan.
December	Minister approves and releases management plan for the following year.

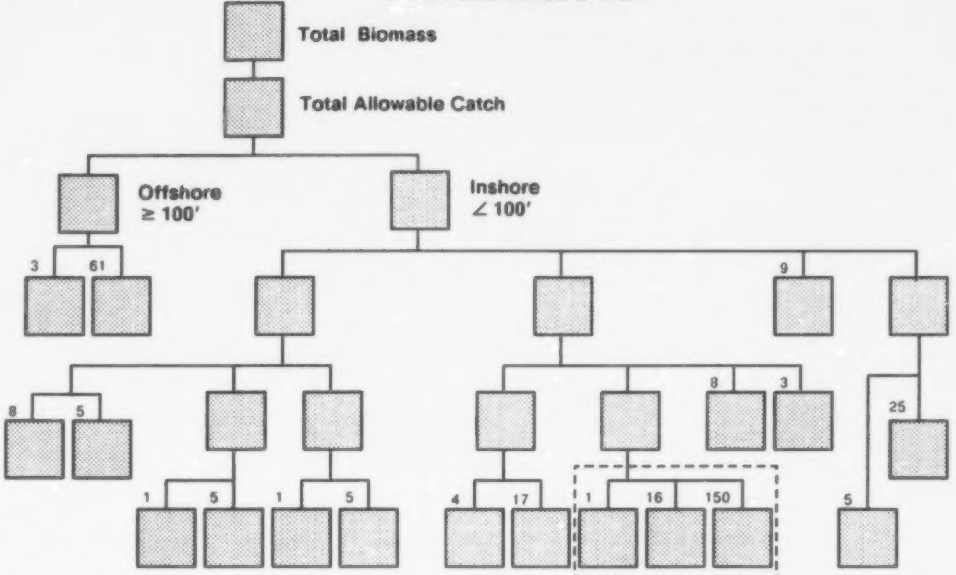
This rigorous and extensive annual process incorporates extensive consultation with, and input from, scientists, industry and politicians. This process helps ensure there is full consideration of biological, social and political implications, but does not allow for full analysis of economic impacts (see paragraphs 13.40 to 13.43). Also, these extensive consultations could be considered as reasons for exempting the Department from pre-publication requirements when issuing regulations based on fishing plans, thus reducing lengthy delays in getting regulations in place (see paragraphs 13.58 to 13.60).

13.37 There appear to have been significant increases in workload for the enforcement function in recent years, with little or no increase in resources. For example, Exhibit 13.4 shows the increase in the number of quotas and allocations to individual enterprises from 1982 to 1987. New quotas and harvesting restrictions often create new regulatory and enforcement requirements. For example, the anticipated increase in misreporting and "dumping" as a result of the introduction of Enterprise Allocations was partially addressed by the Department through increased observer coverage, the introduction of mandatory landing sites, and increased air surveillance and penalties. The effectiveness and costs of these initiatives and others need to be assessed before a decision is made on whether to continue or increase their use.

13.38 Over the past decade the resource allocation scheme and the related licensing provisions have grown annually in complexity and in difficulty of enforcement, while resources

Exhibit 13.3

TOTAL ALLOWABLE CATCH



This chart shows the degree of complexity that could be involved in dividing up the TAC for a single stock. The numbered boxes represent numbers of quotas each of which must be monitored and enforced. Many of the finer breakdowns in the chart are examples of micro-management. The boxes enlosed by the dotted line represent over 150 individual quotas for trawlers in the 45- to 64- foot class to be managed.

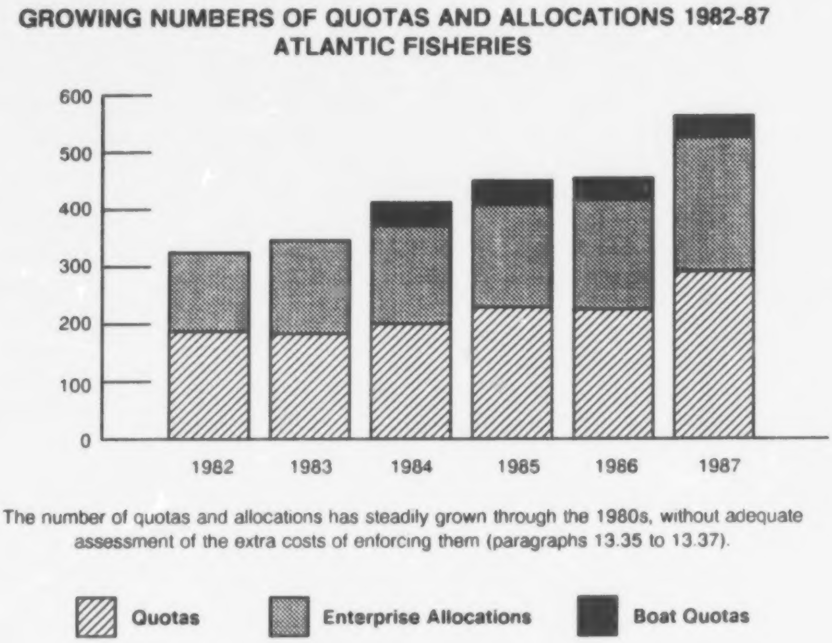
for enforcement have remained roughly constant. This has strained the Department's ability to enforce fully all of its measures. A 1985 evaluation of Atlantic enforcement found that fishermen believed the likelihood of being caught in an infraction was very low. While new enforcement measures, such as increased fines and improved air surveillance, have been introduced since then, one of the most serious effects of an inability to enforce specific regulations would be that, over time, respect for the whole regulatory process could be eroded.

13.39 Before implementing a new resource management approach, the Department should ensure that associated enforcement costs are determined and included in the long-term strategy for the fishery or fleet concerned.

> ***Department's response:*** *We concur. Enforcement costs will be required to be specified in the planning stages during the development of long term resource management strategies.*

13.40 Economic effects. The Department's objectives in resource allocation are both biological (conservation) and economic. The division of the TACs into quotas and Enterprise Allocations – dividing up the pie – has very significant economic impacts, directly affecting income levels for the upcoming year for those involved in the fishery.

Exhibit 13.4



The number of quotas and allocations has steadily grown through the 1980s, without adequate assessment of the extra costs of enforcing them (paragraphs 13.35 to 13.37).

13.41 Studies have been done from time to time to deal with specific short-term and individual long-term capacity problems, and each region gathers the necessary economic data, such as "cost and earnings" studies of different fleet sectors. However, we could not find a consistent process for developing economic advice needed as input to long-term resource management strategies. We would expect a formalized, regular analysis of the long-term economic effects of resource allocation decisions and fishing experience on the economic viability of the various gear sectors making up the fleet, on an Atlantic-wide basis. This analysis would provide resource managers with a regular opportunity to identify long-term capacity problems and would constitute a key element in identifying strategic concerns for the medium term.

13.42 Some steps have been taken to ensure greater co-ordination of economic analysis in the Atlantic Zone and to increase functional involvement. However, these will not result in the type of ongoing economic assessments of the long-term effects of fisheries management that management requires in order to be informed in a timely way of the effectiveness of its program.

13.43 **The Department should improve its capability to provide economic analysis relating to long-term fleet viability and associated capacity adjustments.**

> ***Department's response:*** *We concur. Economic analysis of fleet viability and capacity will be undertaken on a regular basis and co-ordinated through senior management in the Atlantic.*

13.44 In our discussions with departmental managers regarding the lack of these analyses, they have raised concerns about the value and credibility of economic analysis. In their view, to be useful and credible in the resource allocation process, there must be procedures to ensure that the economic analyses provided are both consistent (reliable) and credible. The absence of appropriately rigorous challenge procedures means that there is no assurance that the current advice meets either criterion; this may reduce its credibility with those making resource allocation decisions.

13.45 **The Department should institute challenge and review procedures for economic advice to ensure that the economic advice it receives meets the necessary standards of consistency and credibility.**

> ***Department's response:*** *We concur. Such review procedures are already being developed for department-wide application.*

Licensing and Regulations

13.46 The Minister of Fisheries and Oceans issues licences and registrations giving individuals and enterprises the privilege to fish. Various Acts and regulations allow the Minister to set conditions specifying species of fish, quotas, seasons, fishing areas, vessel to be used, gear-type and the persons permitted to fish. We reviewed, as a control on the fishery, the Department's system of developing and proposing regulatory amendments and the process of issuing fishing licences and registrations for fishermen and vessels.

13.47 **Licensing and registration**. Licensing grants fishing privileges to specified individuals and enterprises in accordance with the fisheries management plans; it is intended to control the fishing capacity in each fishery. It is a controversial and emotional issue within the fishing industry because it is the means by which the basic privilege of fishing is conferred. Given the common property nature of the resource, a privilege given to one person is at the expense of others who compete for the same resource. There are two main licence or registration documents issued to individuals by the Department: Fisherman's Registration, designating an individual as a fisherman; and Species Licences, granting access to a specific species of fish to a registered fisherman. The latter are of two types: open access, available to all; and limited entry, available to full-time fishermen only. All the lucrative fisheries are limited entry.

13.48 Although the licensing system is reasonably effective in controlling access to the fishery and providing some limits on fishing effort, we noted improvements that could be made, as discussed below.

13.49 **Control of the number of licences**. For most inshore species licences, the Department charges a nominal fee (approximately $30 to $50). Departmental officials report that the resale value of these licences can be as high as $50,000 for lobster or scallops, because of their limited number and the high return from these fisheries.

13.50 While a licence is the property of the Crown, the Minister has allowed fishermen to transfer the privilege if the transfer adheres to strict conditions which, as a minimum, require the recipient to be a full-time fisherman. The profit accrues to the fisherman transferring the licence. Occasionally the Department has bought back licences from fishermen, often at very significant costs (see paragraph 3.46), where serious long-term overcapacity exists. Even in some situations where a stock can absorb additional capacity, the Department faces extensive controversy in issuing new licences because fishermen believe that new entrants will take fish away from those already in the fishery. Despite current policies and practices, a species licence is not a right conferred upon a fisherman. In law a licence is a privilege granted at the discretion of the Minister and does not confer any continuing right to the recipient. Nonetheless the policy and procedures for licence transfers currently followed by the Department, which have created a market for licences, have placed significant practical economic constraints on its ability to control the capacity in most fisheries. Given the constraints on the Department's budget, it is unlikely that it can always afford to buy back licences when removal of capacity from a fishery is indicated.

13.51 We reviewed a number of instances where licences were issued giving access to new fisheries (e.g. offshore clams and lobsters) or allowing new entrants into existing closed fisheries (e.g. northern shrimp). Although these confer a very significant economic benefit, and while we found that the decision to allow more effort was based on scientific advice, the Department has not been consistent in how it has made the awards. In some instances a ranking of proposals against criteria was used, in others a lottery. The degree of openness in calling for proposals varied as well. In one instance licences were issued to some who failed to meet all the criteria specified by the Department. The Minister's Atlantic Regional Council has developed policies and procedures that have been adopted by the Department as part of its Licensing Policy Review. Use of these policies and procedures should address our concerns.

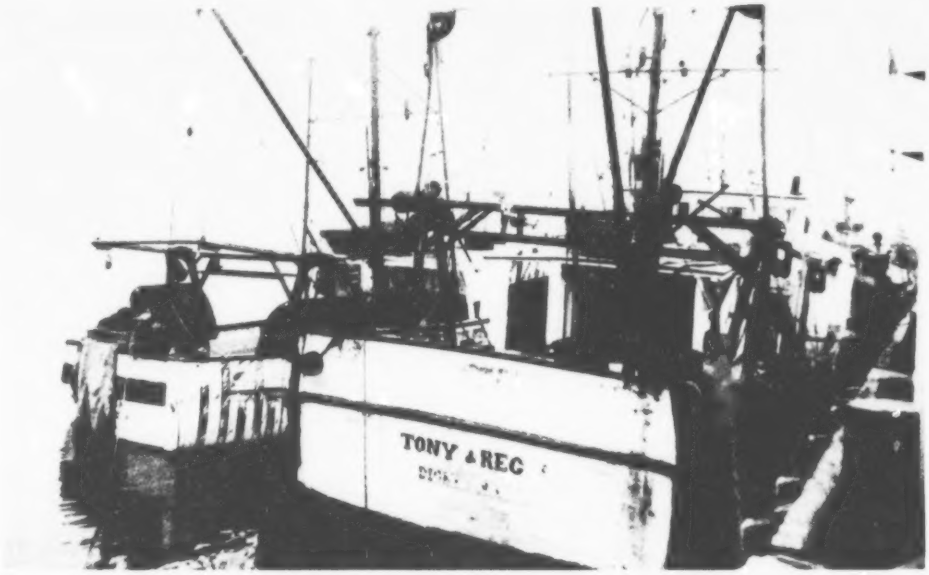
13.52 **Vessel registration**. Vessels used in commercial fishing must be registered. The registration includes the length overall and the vessel's hold capacity. Industry sectors are classed according to 5-foot length intervals, starting at 35 feet. A species licence is invalid if the fisherman uses a vessel larger than the length class permitted in the licence.

13.53 The Department's primary controls over fishing effort are limits on vessel length and on the hold capacity of the vessel. They must be simultaneously enforced as neither represents a complete measure of harvesting capacity. We found that while length controls were being strictly enforced, hold capacity restrictions were not (see Exhibit 13.5). Because the Department has not gathered reliable information on hold capacity, when vessels are replaced the Department is often unable to enforce hold capacity rules. Increases in harvesting capacity are not being controlled. Furthermore, it means that the Department does not have an accurate measure of the capacity of the Atlantic fishing fleet and cannot estimate the extent of overcapacity that exists.

Exhibit 13.5

CONTROLLING HARVESTING CAPACITY

These two vessels are within the same five-foot length class but have obviously different hold capacities. Constrained on length, owners have increased capacity by building broader beamed boats. The Department treats the two vessels as if they are equal. Present licensing policy allows the Department to refuse licenses for vessels which exceed hold capacity rules, but recent registration decisions in one area office indicate a reluctance to do so. A contributing factor to this problem is that fishermen are not notifying the Department in advance of the construction of replacement vessels so that the Department could make a license transfer ruling in advance of construction.



13.54 In December 1985 the Department initiated reviews of licensing and vessel replacement policies to provide a consolidation of policies and regulations, to simplify and standardize rules, and to propose improvements in policy where consensus exists. Proposals are now being reviewed by a federal-provincial working group. Among these is a recommendation to use a relatively simple measure – known as the "cubic number" – of length times breadth times depth as the measure of capacity.

13.55 **Reliable vessel cubic capacity information should be required by the Department before licencing a vessel as a replacement for an existing vessel.**

> ***Department's response:*** *We concur. Following approval of revised groundfish vessel replacement rules, new approval procedures will be introduced. This will include the introduction of a Vessel Replacement Application Form which will be*

> *required to be submitted and approved prior to construction or purchase. Certified vessel measurements will be required.*

13.56 Under current vessel replacement rules there is no requirement for the owner to have prior approval of vessel plans to ensure that the vessel will conform. There have been recent instances where vessels have been built with hold capacities that the Department believes exceed the limits permitted under the vessel replacement rules. Nonetheless these vessels have been registered in the fishery.

13.57 The Department should require that owners receive a vessel construction permit certifying the vessel's conformity with the applicable regulations before construction begins, as a prerequisite to registration of the completed vessel.

> ***Department's response:*** *We concur. The proposed application form will indicate the specifications of the vessel to be replaced and of the one to be built/purchased. In the case of new construction, after completion, shipyard certification of vessel specifications must be filed with DFO prior to licence issuance.*

13.58 **Regulations.** Our review of the regulatory amendment process included an analysis of 57 amendments in process or approved during 1986 and 1987. It took an average of nine months from the time a proposal was received at national headquarters until the amendment was in place. During our 1981 comprehensive audit of the Department, we noted that it took approximately five months. Since our audit, the Department has done a study showing that the time has returned to five months as staff have become more experienced in the new process. Exhibit 13.6 illustrates some of the amendments the Department proposed and the consequences of lengthy processing.

13.59 In September 1986, the Government of Canada introduced a new regulatory amendment system designed to ensure fuller consultation with those affected by regulation changes. The policy requires that review and consultation take place after any regulation is developed. As we have noted, the Department conducts extensive consultations with all stakeholders before developing regulations to implement fishing plans and similar types of documents. Repeating the process after drafting a new regulation wastes time and effort and contributes to delays.

13.60 The Department should consider seeking an overall exemption from pre-publication requirements for proposals based on fishing plans or other instances where extensive consultation routinely takes place.

> ***Department's response:*** *We concur that pre-publication contributes to delays in the regulatory process. A submission will be made to the Minister for Regulatory Affairs seeking an overall exemption from pre-publication of regulations recommended by the freshwater provinces who administer fisheries within their boundaries. The submission will also include those recommended by DFO where DFO can show in the consultation section of a Regulatory Impact*

Exhibit 13.6

CASE STUDIES - REGULATORY AMENDMENT PROCESS

Case 1 - Loss of Revenue

In November 1984, the Minister of Fisheries and Oceans announced that the Department would increase the recovery of its costs for the surveillance of foreign fishing activity in Canadian waters. This goal would be achieved by increasing foreign fishing licence fees by 25 percent a year from 1985 to 1988. The process to amend the 1986 calendar year fee began in September 1985. Because of confusion within the Department concerning the necessary approvals, the request was not submitted to Treasury Board until June 1986. Treasury Board rejected the submissions because of questions about an unrelated amendment in the same package. The fee increase request was then severed from the unrelated amendment and approved by the Board at its 12 August meeting. The Department obtained an exemption from the usual pre-publication requirements and obtained approval for the amendment on 11 September 1986.

The nine-month delay in obtaining approval for the fee increase resulted in lost revenues to the Crown of approximately $600,000.

Case 2 - Bay of Fundy Scallop Fishery

To obtain limited access to the lucrative George's Bank scallop fishery, fishermen from the Bay of Fundy area agreed to a series of conservation measures designed to rebuild the Bay of Fundy stocks. Extensive consultations took place throughout 1986 and until May 1987. By the time final agreement was reached with the scallop fishermen, it was impossible to have the conservation measures enacted in regulations for the opening of the season on 1 October 1987. The Department made a "gentlemen's agreement" with the scallop fishermen but as some broke the agreement, non-compliance became widespread. Consequently the only option available to ensure conservation was to close the entire fishery.

This case demonstrates the need for expeditious implementation of regulations to support the Department in conservation measures, even when these measures have been agreed to by fishermen.

Analysis Statement that there has been extensive consultation with affected parties through the development of fisheries species management plans or other consultative mechanisms.

Enforcement

13.61 The final element in the Department's resource management role is enforcing the fishing plans, licensing requirements and regulations that it put in place. The most recent estimate available of the extent of illegal fishing activity is from a 1985 program evaluation that, using 1982 data, estimated the value of illegal fishing activity in the Atlantic Zone to be in the order of $100 million a year. We examined the Department's management of, and support for, its enforcement activities.

13.62 In the Atlantic Zone, of 469 Fishery Officer person-years, 426 are allocated to the inshore and 43 to offshore surveillance. Of these, 55 percent are only employed on a seasonal basis. Fishery Officers are on the front line, in daily contact with the fishery and responsible for making it work, and much of the success or failure of the Department's program depends on how well these men and women do their jobs. It is a complex and stressful job. The Officers both police the fishery and serve as the eyes and ears of the Department. Their role includes communicating departmental policy and concerns to the fishermen, providing a focal point for discussion of fishery problems, and assisting communities to manage their fishery. In much of Atlantic Canada, the Fishery Officers and their families live in the communities where they work, with the people whose work they must police.

13.63 In the policing role, Fishery Officers often work alone; or sometimes in pairs. The areas to be covered are often large and remote, and poachers have shown, in some areas, a growing tendency to respond violently to the possibility of being apprehended (a situation we observed). In this environment, enforceable rules, adequate transportation equipment in the form of serviceable vehicles and boats, and reliable communication to keep in touch and summon help when needed, are essential. Many of the important support mechanisms for a Fishery Officer in performing this role are weak. Furthermore, the information to plan, control and evaluate the efficiency and success of operations is often inadequate or inconsistent.

13.64 The Department's method of developing and distributing enforcement policies and approaches is through national and functional committees. The current structure appears to provide a basis for developing new initiatives and sharing enforcement methodology and practices. However, the Department has had difficulties in implementing them.

13.65 **Implementing new strategies.** In June 1986, the Minister of Fisheries and Oceans announced several initiatives to increase the effectiveness of the Department's offshore surveillance and enforcement activities. We reviewed the implementation of three of the more costly and significant of these: arming the Department's five offshore patrol vessels and providing an armed boarding capability; developing more effective air and sea surveillance; and leasing a dual engine helicopter for offshore surveillance from the deck of a patrol vessel.

Fishery officers often work alone, performing dangerous tasks. In this case the Officer is checking some netting snagged on the rocks, suspecting that illegal lobster traps may be attached (see paragraph 13.63).

13.66 **Arming of fisheries patrol vessels and armed boarding.** Cabinet authorized the Department to place weapons on board its patrol vessels and gave crews and Fishery Officers the capability of boarding fishing vessels offering resistance. While the Department adequately identified the need for an armed capability, there was incomplete information on many of the costs and other factors involved. As a result, the total estimated costs rose from $610,000 in October 1986 to $3.7 million in February 1988. While some boardings have taken place, full implementation has been delayed because of difficulties in acquiring and installing equipment on the patrol vessels and in completing training for all ships' crews.

13.67 **Improving aerial surveillance.** The Department entered into a one-year contract to lease a King Air Beechcraft aircraft (based in St. John's) equipped with a highly advanced radar. The Department has data that show that, while this contract is more costly on a flight-hour basis than its arrangement with National Defence, the fact that all flight time is productive (as opposed to less than half in the case of the DND aircraft - based in Summerside) and the more advanced surveillance technology on the King Air, appear to more than offset the difference.

13.68 **Acquisition of surveillance helicopter.** As an experiment, the Department of Fisheries and Oceans leased for three years a helicopter for offshore fisheries surveillance, operating from the deck of a patrol vessel. We have concerns about the acquisition of these services, including inadequate assessment of the number of days when conditions would

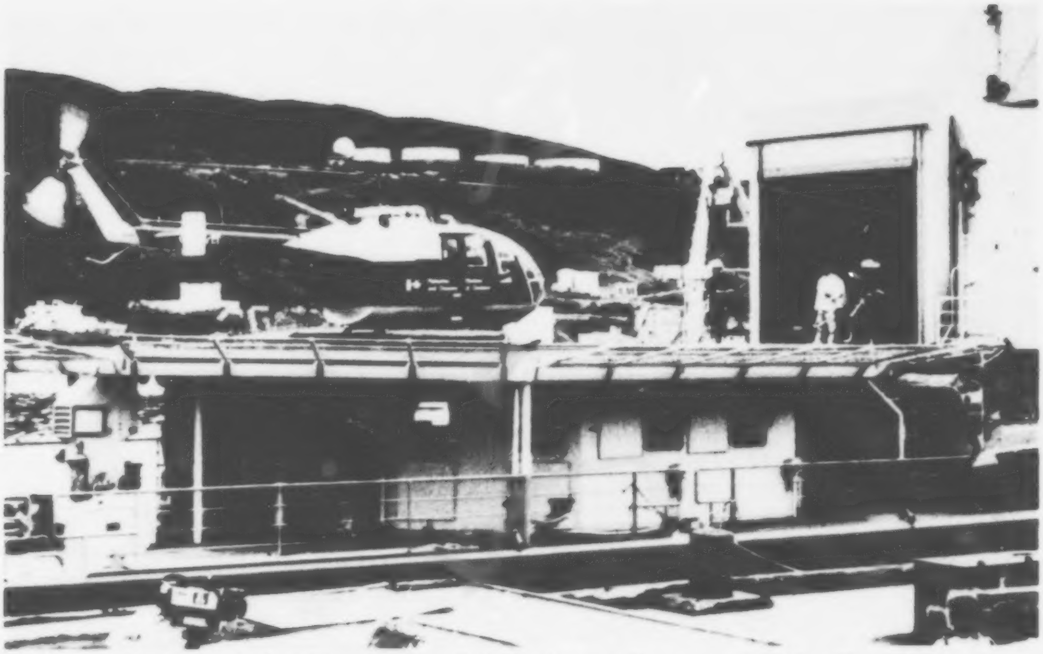
One important part of DFO's enforcement strategy is aerial surveillance. Here the Department observes a trawler from St. Pierre and Miquelon travelling through Canadian waters (see paragraph 13.67).

permit this helicopter to be used; and the failure to consolidate and gather appropriate data to evaluate the experiment. The costs associated with this acquisition include annual leasing costs of $1.3 million and the costs of modifying a fisheries patrol vessel to make it suitable. As reported in paragraph 19.99 of the Special Audits Chapter, given the sea and air conditions prevalent 200 miles offshore, the helicopter will frequently be unable to perform its intended role, although the extent of the shortfall from the planned usage can only be determined after a full year in all sea and weather conditions.

13.69 Since our audit, the Department has delayed spending $1.4 million to modify a second fisheries patrol vessel until more data are gathered on flight operations. The Department has indicated that it will institute more rigorous data gathering techniques.

13.70 In addition, the Department has been using a significant number of shorter-term leases to acquire the services of fixed and rotary wing aircraft for surveillance. The Department lacks expertise in aircraft acquisition and evaluation. Given the increased use of aircraft, we would have expected the Department to have aircraft expertise available, either on staff or on a contract basis.

13.71 **Procedures should be refined to better assess the need for, the technical requirements and costs of, and the most appropriate method of acquiring major equipment required in connection with all enforcement initiatives.**



A three-year lease of this helicopter for offshore air surveillance cost $3.9 million, plus the cost of vessel modifications (see paragraph 13.68).

> ***Department's response:*** *We agree. The Department is developing a monitoring, control and surveillance model in an attempt to better assess the need, technical requirements and costs of new major capital acquisitions for the enforcement program.*

13.72 **Communications equipment**. Radio communications play an essential part in enforcing and managing the fishery. We reviewed communications support and found several systems in use, resulting in incompatibilities and patchy and uncertain coverage in some areas. The Department has recognized these deficiencies and has identified a replacement system which will cost approximately $4 million in capital funds and $430,000 annually in operating costs.

13.73 After many studies of this issue, the Department is placing priority on improving communications. A four-year national plan has been formulated, starting with $1 million being allocated in 1988-89 to make improvements in the Pacific and Central and Arctic Regions.

Acquiring and Operating Small Vessels

13.74 In the Atlantic Zone, the Department operates 31 inshore patrol vessels that range in size from 40 to 80 feet. These vessels, each having dedicated crews of two to four, use approximately 68 person-years. They are primarily day-boats that operate no more than 20 miles from shore. In productive operation the boats would carry, in addition to the crew, Fishery Officers who would carry out any enforcement activities that needed to be done. Usually the crew is there strictly to operate the boat. We analyzed a sample of logbooks to identify the tasks performed by the vessels and crews. Exhibit 13.7 shows the percentage of days at sea for these boats.

13.75 **Productive operational arrangements.** The operational effectiveness of the Atlantic fleet would be increased if as many crew members as possible were given additional training and gazetted as Fishery Officers having full powers under the Fisheries Act. Then more time spent at sea would be productive time, and when sailing was not possible because of weather, lack of crew or lack of work, the Officers working as vessel crew could be redeployed to more productive duties ashore.

13.76 In some areas of the Scotia-Fundy and Gulf Regions, crews are voluntarily assisting Fishery Officers performing land patrols, and in the Pacific Region, crews and captains act as Fishery Officers by patrolling remote streams accessible only by boat.

13.77 Changes would require union consultations and new job classifications. However, the Department was able to require the crews of offshore vessels to participate in armed boarding parties – a strenuous and potentially dangerous task. Although many of the current crew members might not be capable of performing Fishery Officer duties, such requirements could be phased in.

13.78 **Wherever feasible, the Department should extend the practice of having members of the crew of inshore patrol boats gazetted as Fishery Officers in addition to their other relevant qualifications.**

> ***Department's response:*** *We concur. The Department will be investigating methods to better utilize its ships' personnel in an enforcement role where practicable and enforcement duties do not detract from their primary duties of operating and maintaining the vessels.*

13.79 In our 1986 Report, we reviewed the Department's acquisition of large vessels (paragraphs 14.63 to 14.73). During the present audit we reviewed the acquisition of two classes of smaller vessels – 42-foot and 22-foot vessels.

13.80 **Acquisition of 42-foot patrol vessels.** From July 1984 to November 1987, the Department purchased ten 42-foot fiberglass vessels with Northumberland hulls. It adequately identified the need for vessels of this size to meet its enforcement responsibilities. However, repeated complaints from skippers led to the commissioning of a marine surveyor to evaluate the operational performance of four of the ten vessels of this type. He concluded: all four tested vessels were difficult to control and were hazardous to operate in moderate wind and sea conditions, particularly when manoeuvring down wind; weight distribution of some installed equipment had been inadequately controlled; some equipment was impossible to operate or maintain because of installation peculiarities; and corrective action was needed to reduce the risk of casualties by providing more directional stability to these vessels.

Exhibit 13.7

SMALL VESSEL UTILIZATION IN 1987

Activity	Percentage of the fishing season
At sea, with Fishery Officer (working)	15.5%
At sea, without Fishery Officer	19.0%
Total Days at Sea	**34.5%**
Total Not at Sea	**65.5%**
TOTAL FISHING SEASON	**100%**

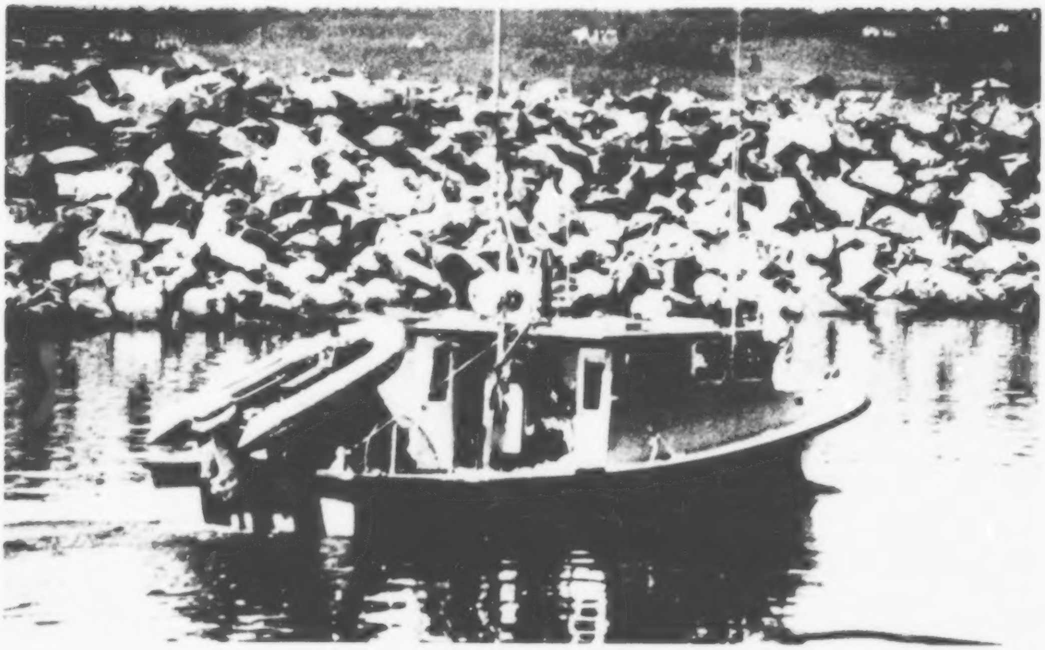
Vessels do not go to sea for a number of reasons, including the seasonality of the fisheries, bad weather, illness, or the unavailability of crew working on other tasks. Departmental officials do not have confidence in the explanations given in the logbooks for the days not at sea. A study to provide a detailed analysis of vessel utilization is now under way.

13.81 In response, the Department has undertaken numerical modelling to assess the extent of the problem. This has been completed and two vessels have been modified. Sea trials on these modifications will be undertaken presently.

13.82 These problems seem, in large measure, to be the result of poor management control over the vessel acquisition process. Design changes after the contract was signed were made by headquarters, the regions and the builder, often with inadequate documentation. Such changes can have unintended effects; for example, on vessel stability. In these circumstances it would be reasonable to have an analysis of the impacts of changes affecting the weight distribution or "windage" of the hull. The Department failed to monitor adequately the effects on stability, handling or operational capability brought about by these changes.

13.83 **The Department should ensure that changes in the design of vessels it acquires are adequately documented and that significant proposed changes are fully analyzed for their impact on stability and other boat's systems.**

Department's response: *We concur. DFO will ensure that procedures are followed for configuration control of DFO's vessels.*



One of the Department's 42-foot Northumberland hull patrol boats. On average, for a number of reasons as noted in Exhibit 13.7, DFO small vessels patrol only one third of the time (see paragraph 13.80).

13.84 Acceptance should be based on dockside inspection tests and on sea trials. We noted a number of instances where full sea trials were waived by the Department. Some of these cases are described in Exhibit 13.8. In one case, the region wanted a patrol boat with a top speed of 25 knots to catch poachers. The contract specified 25 knots as a requirement, adding significantly to the cost of the vessel. Although the vessel managed only 20.7 knots in sea trials, and the region made a written reservation, the Department provisionally accepted the vessel. The region later reported that this vessel was not fast enough to catch suspected poachers. The Department is attempting to further assess this problem.

13.85 Significant costs were incurred in making post-delivery modifications to certain boats to meet Canadian Steamship Inspection requirements, enhance stability and improve handling capabilities. The original cost of these vessels varied from $194,000 to $444,000. For three of these vessels, over $100,000 each was spent on modifications within two years of delivery. In one instance, modifications costing $113,000 were made on a boat before completion of modelling and tank trials intended to assess its seaworthiness and performance.

13.86 **Acquisition of 22-foot inshore patrol boats.** Having identified the need for standardized small inshore patrol boats through its vessel acquisition strategy, the Department commissioned the design and construction of an aluminum hulled vessel. This was intended to be light and transportable to meet the needs of Fishery Officers in the Atlantic for a small work boat.

Exhibit 13.8

VESSELS ACCEPTED WITHOUT FULL SEA TRIALS

VESSEL J.W. DERASPE, cost $341,890

28 March 1986	Vessel accepted before sea trials.
28 May 1986	Fuel tanks rupture and are repaired under warranty.
15 July 1986	Sea trials conducted that show inadequate speed, excessive fuel consumption and excessive weight.
26 August 1986	Steamship inspector limits operations to 2 miles from shore. Subsequent modifications completed at a cost of $22,216.

VESSEL 87-5, cost $436,918

Final milestone of 15 percent was to be paid on completion of owner's trials and settlement of deficiencies. $57,677 of the $60,677 final milestone payment was paid before completion of final trials. Remaining tests or trials included bilge system, fire main and hose tests, anchor windlass, freshwater system, sanitary system and full sea trials, in addition to replacement of an engine.

VESSELS 6C 4827 AND 6C 4828, cost $373,276 and $263,276 respectively

Trials on 6c 4828 were waived to avoid financial hardship for the builder, caused by an early winter. Subsequent modifications required on 6C 4827 cost about $113,000.

VESSEL 87-1, cost $357,806

Full sea trials were waived because of the failure of certain equipment and because the vessel was required for Search and Rescue duties. On 27 May 1987, the Department of Supply and Services inspector reported that the trials on this vessel were "unsatisfactory". On 10 June 1987 the captain of the vessel described concerns about the safety of the vessel, reporting that it was down in the bow and that there were stability problems. A marine surveyor hired by the Department also questioned the safety of this vessel, citing engine vibrations and a list to port. The boat has been modified and new sea trials are being done.

13.87 Many of the operators of these boats reported, however, that operating and maintenance costs were high because of the weight and complexity of the vessel. Their experience indicated that, for most applications, the boat was too heavy for easy transportation and launching, costly to operate, failed to provide acceptable accommodation for the second crew member and was difficult to maintain in field conditions.

13.88 **The Department should enhance its procedures to ensure that boats are designed and built to meet the needs of the users.**

> ***Department's response:*** *We concur. Design is an iterative process that calls for compromises between often competing requirements. Our procedures will be improved to ensure that users are fully involved in the initial setting of requirements as well as in decisions throughout the design and construction process where there is a need to move away from the initial requirement.*

The Fish Inspection Program

13.89 Through the Fish Inspection program, Fisheries and Oceans inspects fish processing and handling facilities and fish products to provide reasonable assurance that these meet Canadian and international standards. The program expends approximately $25 million annually with about 500 authorized person-years.

13.90 We were impressed throughout the audit by the high international reputation of Canada's fish inspection program. Few other countries have such a comprehensive system. Also noteworthy is the Department's work with industry to improve fish product quality. One component of quality improvement is still missing – product grade standards which permit the consumer to differentiate between standard and premium quality fish. The Department's negotiations with industry to introduce these have been unsuccessful to date.

13.91 The Fish Inspection program faces considerable pressures. Many of these relate to past incidents involving fish products. The most notorious was the "tainted tuna affair" of September 1985. Since then tuna has, understandably, preoccupied management and operations to an extent far exceeding its relative importance. A number of management initiatives and ongoing management controls were postponed because of this.

13.92 While the incident was very disruptive, it also spurred and accelerated improvements in program management and control. One far-reaching change was the strengthening of national control of the program.

13.93 At the front line of the program are 271 field inspectors. Apart from regular contact with their supervisors, they work alone and provide periodic inspections of processing plants on their circuit and of the boats and loading facilities in their district. The program is responsible for the fish from "net to warehouse", and an inspector's day can find him or her anywhere in between. Inspection work can involve inspecting the hold of a dragger to ensure that fish are of acceptable quality and are properly iced and stored, that proper unloading

Proper icing, bleeding and boxing of fish is now a common practice in the Altantic fisheries, due in part to the Department's efforts to promote quality improvements (see paragraph 13.90).

procedures are being followed and that, after unloading, the hold is properly cleaned. It can mean checking out unloading procedures on a wharf or in the hold room of a plant. A considerable part of their time is spent in the plants reviewing operations and inspecting the product as it is being processed.

13.94 Additionally, the program conducts detailed assessments of the construction and operation of Canadian plants to ensure that they adhere to good manufacturing practices. These are followed up by regular operating inspections. Cumulatively, this continuity of inspection is intended to provide a certain level of assurance on product quality by preventing or culling defective product.

13.95 The final major element in this strategy is truly "the proof of the pudding"; the inspection of the final product to verify that the product indeed meets standards. There are two types of final product inspection: chemical and bacteriological analysis, and sensory inspection. They are separate procedures and look for different things.

Chemical and Bacteriological Analysis

13.96 The chemical and bacteriological analysis is done on samples of the product to provide assurance that they are free from harmful bacteria, toxins, chemical contaminants and high levels of heavy metals. These are the principal health and safety concerns in fish. We examined the policies and procedures set out by management and the controls on these operations. We concluded that the policies and procedures were consistent with the objectives and that the controls were sufficient to give management reasonable assurance that they were being followed.

Sensory Inspections

13.97 Sensory inspections focus on the quality of the final product and are concerned with matters such as texture, palatability and the absence of bones or fins. They are intended to provide assurance that the final product meets minimum quality standards.

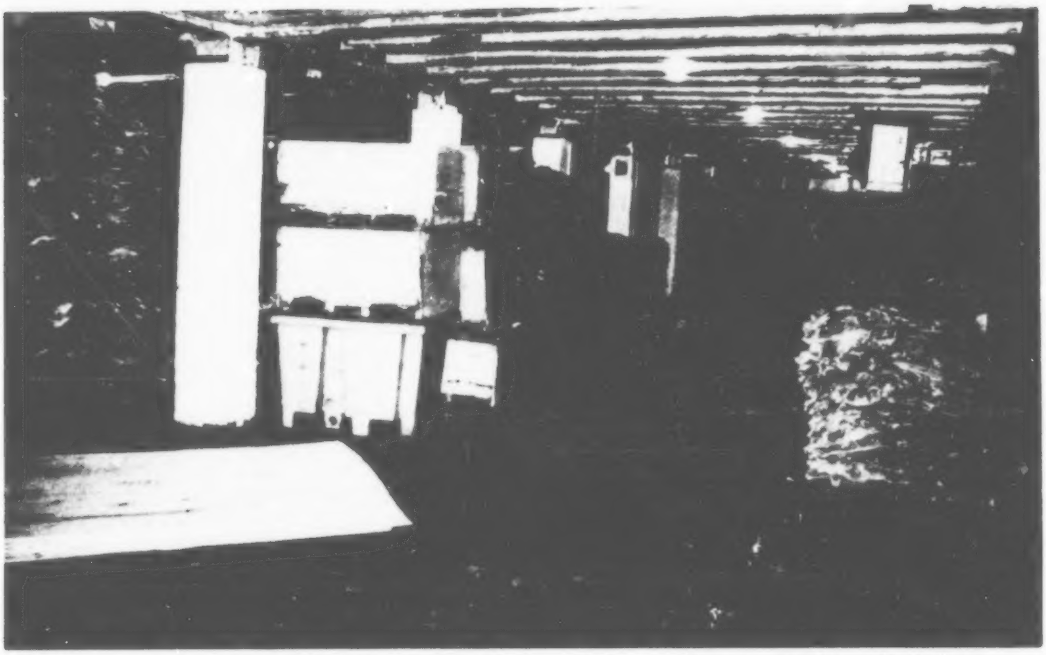
13.98 Except for its sampling procedures, the Department's procedures, where they exist, for in-plant inspections are appropriate and relevant to its program objectives. However, we also found that in some areas of the program there are no official standards and procedures. Procedures that are in place are not always implemented consistently, as discussed in paragraph 13.105.

13.99 **Sampling.** While all sampling plans have limitations, we have two serious concerns about the validity of the inspection sampling procedures that the Department has adopted. This validity is critical, since conclusions about the quality of large volumes of fish products are made on the basis of the quality of the samples examined.

13.100 First, the most often used sampling procedure controls the risk to the producer that inspectors will reject above-standard product to a greater extent than it controls the risk to the consumer of receiving below-standard product. Although the procedure is internationally recognized and the other program elements are believed by the Department to ameliorate the limitations of this type of plan, its use is incompatible with the program's objective – to ensure that below-standard products are not marketed – especially where final product inspection is the only inspection procedure used.

13.101 Second, the Department has developed its own sampling procedures, some based on traditional methods, to check for decomposition defects and to test specialized products such as cured fish. These do not conform to any internationally recognized sampling procedure and increase the likelihood that above-standard lots will be rejected by inspectors. The impact of this type of error is limited by the fact that the company has a right to appeal the inspection decision, and to have a re-inspection done by three inspectors.

13.102 As noted earlier, final product sampling is only one of the controls, albeit a key one, in the inspection process. The other elements may help offset weaknesses in sampling procedures. The Department has relied on complaints, feedback on certified products and incidence of illness to determine if adequate results are achieved by the program. None of these indicators is, however, a truly valid measure of the extent to which fish products meet standards. We would be less concerned if management had done an objective and valid analysis to determine the degree of reliance that can be placed on the other controls.



Sampling validity is crucial because large volumes of fish can be accepted or rejected on the basis of the results of a few samples (see paragraph 13.99).

13.103 Another problem further undermines the efficacy of the sampling approach. The majority of inspectors of groundfish only examine the fish produced while the inspector is in the plant, not what is produced between visits. Also, most inspectors only work day shifts, whereas, in the peak processing season, many plants work two or more shifts. Hence their sample results apply to only a very small part of the total production. An exception occurs when the inspector issues an export certificate for the inspected product. In these cases, inspectors do not restrict their sampling to production during the inspection visit. However this covers less than three percent of the groundfish subject to inspection.

13.104 **Sensory evaluations.** Inspectors rely on colour, smell, texture and taste to determine if fish products are acceptable. It is critical that sensory evaluations by different inspectors arrive at similar conclusions. However, with the exception of tuna inspectors, the Department lacks adequate evidence of the reliability of sensory evaluations done by its inspectors. Because there is no complete systematic testing, evidence is not available to show reliably whether inspectors are reaching similar conclusions from sensory evaluations.

13.105 **Inconsistencies in standards and procedures.** Our audit identified inconsistencies in the standards used by inspectors. Different inspectors in different areas of the country inspect products somewhat differently. Many of these differences are minor. However, in cases of borderline quality, some could significantly increase the chance of rejecting above-standard product or accepting below-standard product. Many inspectors

More training and testing are necessary to ensure that inspectors are consistent in their sensory evaluations of products (see paragraph 13.104).

were using standards not approved by the Department, or, where no standards exist, were making up their own. Some inspectors use their own unauthorized sampling procedures in some situations. These unofficial procedures have no scientific validity, and are more likely to result in incorrect inspections decisions.

13.106 **Implications of Inconsistencies.** Two general conclusions follow from these inconsistencies. First, although the limited amount of available information on program results does not suggest that major errors are occurring in marketed products, it is probable that some amount of below-standard product reaches the marketplace due to inconsistencies. In most cases, this product would be below minimum quality standards or mislabelled, but not bacteriologically or chemically contaminated, and hence not a threat to health or safety.

13.107 The probability of below-standard product reaching the marketplace is ameliorated by other controls in the system; for example, the industry's own quality controls at the plant, wholesale and retail levels. However, the Department has no analysis of the efficacy of these controls.

13.108 Second, it is probable that some amount of above-standard product is rejected and hence reinspected, reprocessed or destroyed due to inspection inconsistencies.

Management Control Weaknesses

13.109 There is no single cause of these problems. They are the result of a number of management control weaknesses. Most of them are long-standing problems. Many have been identified in past studies, including our 1981 audit.

13.110 Until about 1985 the regions largely ran their own inspection programs. This situation, and the diversion of management attention to solving problems such as the tuna crisis, probably accounts for some of the lack of progress in correcting management control weaknesses identified as long ago as 1981. However, national program and national management cadre were developed in 1986. The Department also states that a number of positions have been dedicated to dealing with these problems. We have cited the Department's target dates in the discussion that follows.

13.111 In general, management knows about these problems and has initiated or planned action. However, the extensive number of improvements that are needed, and continuing demands on the program that have already created delays, pose major challenges to management. Moreover, until management control improvements are complete, there is greater risk of inspection inconsistencies.

13.112 **Insufficient training.** Although a variety of species-specific workshops have been held in recent years, formal training has been heavily curtailed, and the program has relied on on-the-job instruction. This is particularly problematic for training sensory evaluation skills, where experienced inspectors can pass errors on to new inspectors.

13.113 The Department is now developing a series of national training modules that will be available for inspectors in each region. The Department expects that the program will be fully developed by March 1989, that a training needs assessment will be done for each inspector by May 1989, and that training delivery will begin in June 1989.

13.114 **Inspector testing**. It is also important to test inspectors to ensure that they have basic sense acuity; valid and reliable sensory evaluation skills; knowledge of inspection standards, procedures and regulations; and are free of communicable diseases. We found that, with the exception of sensory testing for tuna inspectors, inspectors are not systematically tested when hired or at regular intervals thereafter.

13.115 Testing of the analytical skills of chemists and micro-biologists was satisfactory. Plans exist to implement similar procedures to test inspectors' sensory evaluation skills. Research is also under way to relate sensory evaluation decisions to chemical measures of decomposition and taintedness. Regular research on such matters had not been done in the program since the closing of its research and development facilities in the 1970s.

13.116 **Manuals.** Manuals outlining the standards against which the inspected product is to be assessed are incomplete, out of date and infrequently used. Rather than updating existing manuals, the Department had relied on memoranda sent to regional and area offices from time to time, when standards and procedural decisions were made, changed or clarified. However, no record has been kept of these memos – they were not numbered or catalogued – and many are now lost and forgotten by national headquarters. As a result, each region, area office and, in some cases, each inspector had a different set of procedures and standards from which to work.

13.117 Work began in 1987 to reissue a set of national inspection procedures manuals. The Department expects that portions of all four manuals will be issued in 1988 and that two of the four manuals will be completed in 1989.

13.118 **Field reviews.** There is no systematic program of reviews of field operations to ensure inspection consistency. On the Atlantic coast, two regions have regular reviews, one has not had any, and one has had occasional reviews. Moreover, except for import laboratories, there are no national reviews to ensure that different regions use consistent procedures. The Department intends to begin reviews in 1989-90, once inspection manuals have been issued.

Efficiency Improvements

13.119 Achieving economy and efficiency in delivering the inspection program is important, as the savings could be directed to correcting management control deficiencies. We identified three areas where the Department is pursuing greater efficiency.

13.120 **Sampling.** A departmental study, to be finished in October 1988, estimates that revised methods might require roughly 40 percent fewer samples to provide the same degree of inspection assurance. If a new sample plan is chosen, it will be fully implemented by 1991.

13.121 **In-plant quality control.** A significant proportion of the fish products industry has quality control programs staffed by quality control employees independent of plant operation. They conduct many of the same inspections as departmental inspectors.

13.122 However, the Department has not yet relied on in-plant quality control to ensure that standards are met. It could begin now to make such arrangements with individual plants which have effective quality control procedures. Estimates have not been made of the possible savings, but they are likely to be substantial. The Department is developing procedures to evaluate in-plant quality control. These are expected to be completed by 1991.

13.123 **Cost recovery.** Cost recovery fees were introduced in 1985 for some parts of the import inspections program. The fees recover only direct costs, not the indirect costs incurred by the program. A number of other opportunities exist for cost recovery, particularly in view of the fact that many plants rely on the services the Department supplies free, rather than incurring the costs of providing their own quality control. The Department expects to initiate new measures by 1991.

The Fishing Vessel Insurance Plan

13.124 Under the Fishing Vessel Insurance Plan (FVIP), about 8,000 vessels were insured by the Department at 31 March 1987, with a total insured value of $415,025,000.

13.125 Since 1965, numerous reviews and studies of FVIP have been done. Deficiencies in management practices have been noted repeatedly over the past 23 years. We identified many of these same deficiencies in our audit. Although the findings of these past studies were accepted by management and action promised, there was little evidence that the problems were subsequently resolved. In response to our 1977 audit, the Department stated "action has already been taken with respect to many of the observations ... the remainder will be resolved in conjunction with a major review of FVIP now being undertaken." Following a 1985 decision by the Minister against privatization, another study has just been completed and an action plan is now being developed.

FOLLOW-UP ON 1986 RECOMMENDATIONS ON PACIFIC AND FRESHWATER FISHERIES

Introduction

13.126 The 1986 value-for-money audit of the Pacific fisheries was the first phase of our audit of the Department of Fisheries and Oceans. The second phase, on the Atlantic fisheries, is reported in this chapter.

13.127 Our audit of the Pacific Region concentrated on the key operational activity of the Region – fisheries management. We conducted our examination and identified weaknesses in the following four areas: the regulatory framework, in-season fisheries management for salmon and herring, the Salmonid Enhancement Program (SEP), and the management of regional resources.

The Regulatory Framework

13.128 **Monitoring the costs and benefits of the Pacific fisheries.** In 1986, we reported that the Pacific Region did not have overall measures to clearly indicate the net economic and social benefits of the Pacific fisheries. We recommended that it should maintain and report such measures and, where benefits were indicated, publish the results periodically.

13.129 The Region stated that increased reporting of economic and social benefits has since been included in Part III of the Department's Estimates. In the 1988-89 Part III there are general references to national economic indicators and to fish returns and landings in the Pacific, along with some goal statements relating to socio-economic optimization and increased industry viability. In our opinion, these do not constitute the reporting of results or measures of benefits for the Pacific fisheries.

13.130 However, since our audit, several studies have been completed on the economic benefits and net returns of the salmon fisheries, both commercial and recreational. Also, the Region arranged for the development of an evaluation framework of their Adaptive Management System (AMS). A portion of the framework deals with the measurement of net economic benefits that could result from the use of AMS. With these initiatives, along with the restructuring of the consultation process through advisory groups, the Region believes it is in a better position to monitor and report the benefits of the Pacific fisheries.

13.131 Thus there has been significant progress toward implementing the measures recommended in our 1986 audit. As the reporting of these benefits is an important and ongoing activity, we will continue periodically to monitor the Region's efforts in this area.

13.132 **Tax expenditures.** In 1986, we observed that the accelerated capital cost allowance (ACCA) contributed to increased fishing capacity by encouraging fishermen with relatively high incomes to invest, in good fishing years, in capacity expansion. We recommended that the Department and the Pacific Region review and monitor the implications of factors such as the ACCA.

13.133 The Region has subsequently issued a report on the nature of the excess capacity problem in the commercial fisheries, including the range of policy actions to address the problem. A Financial Impact Simulation Model and a study of the five-year financial performance of the salmon fleet are other initiatives undertaken by the Region relating to this issue.

13.134 The Region is continuing to monitor the implications of such factors as the ACCA, which is the responsibility of the Minister of Finance. The Department has informed us that the Minister of Fisheries and Oceans has written the Minister of Finance on a number of occasions to express his views on the ACCA.

13.135 We are satisfied that the Department has acted reasonably in response to our observations and recommendation on this issue.

13.136 **Vessel capacity information.** We reported in 1986 that the Region had little information on the catching capability of the fishing fleet, particularly the relationship between vessel capacity and stock levels. We observed that volumetric measures, which determine the volume or carrying capacity of boats rather than just their length, would help improve this information. Our recommendation related to implementing such measures and to developing other indicators to determine excess fleet catching capacity.

13.137 Since our audit, there has been substantial activity and discussion in this area. The Department undertook a study of volumetric vessel measures, but became concerned about the cost of implementing the measures, and about who should pay for the measuring – government or industry. In the meantime, there was a growing number of abuses by vessel owners who were increasing their above-water carrying capacity without changing the registered dimensions of the vessel. This led the Minister to suspend some licences and expedited the process of trying to resolve the situation.

13.138 A proposal is being developed whereby vessel owners will be required to verify the dimensions of their vessel through a certified survey. It has been proposed that issuance of 1990 salmon licences be contingent on the fisherman or vessel owner providing the required information. A "cubic number" measurement is being proposed, similar to the vessel measurement initiative currently being pursued in the Atlantic fisheries.

13.139 These proposals are currently being reviewed by the Minister and his advisory council. We will continue to monitor progress on this important issue.

Fisheries Management: Salmon and Herring

13.140 **Scientific information.** The 1986 audit identified a lack of the accurate, timely and complete information needed to manage the salmon fisheries, particularly in relation to escapement. Escapement targets were often not based on sound scientific information and theory. Also, the Region did not regularly record, monitor or assess the quality of such information.

13.141 We recommended that the Region develop and implement plans to improve information required for managing fish stocks, and set up quality control procedures to ensure reliable collection and recording of at least minimum information.

13.142 Although the Region anticipates it will be March 1989 before it has defined its minimum program information requirements, substantial progress has been made in a number of areas to improve information for managing stocks. The Pacific Stock Assessment Review Committee (PSARC) has been fully implemented, with emphasis on improving stock assessment information for all species, particularly in relation to developing improved escapement and catch data. Also a major project, examining the impacts of marine conditions on survival and recruitment of salmonids, and other scientific studies of key information requirements and experimental methods are in progress.

13.143 In addition, fisheries management information is being consolidated in a series of three reference reports compiled at the district and area levels as part of the Region's Adaptive Management System. Ensuring greater involvement of District Supervisors and other middle managers in fisheries management reporting has slowed down the process of implementation.

13.144 We recognize the progress that has been made to date to improve information for fisheries management, and we will continue to monitor implementation of these improvements.

13.145 **Economy and efficiency of in-season salmon management - communication equipment and boats.** In 1986, we noted the importance of radio communication as the operational system that links field activities with resource management and enforcement decisions, and assists Fishery Officers in potentially hazardous situations. We found that the Department's goals were at risk due to insufficient installation and maintenance of communication equipment.

13.146 Because of the critical role they play in the fisheries, we also examined various aspects relating to the Region's management of its small boats (10 to 30 feet in length). We observed a lack of consideration for overall fleet standardization in the acquisition and equipping of small boats, and weaknesses relating to the assessment of operational needs, proper maintenance practices, and training and certification in vessel operation and maintenance.

13.147 Our recommendation addressed the weaknesses noted above, and the application of proper capital management principles, particularly in relation to assessing operational needs and considering alternatives for fulfilling them.

13.148 The Department has prepared a long-term capital plan to address weaknesses in the management of capital assets. The implementation of this plan is intended to follow the accepted principles of life-cycle management of capital assets. It is too early for us to assess the Department's success in implementing this plan or the extent to which the weaknesses identified in our Pacific audit will be addressed.

13.149 Regarding the needed improvements to radio communications equipment, the Department conducted a study of the communications systems that addressed both the operational and the safety requirements of the radio systems. This study has been incorporated in a four-year communications plan, with the Pacific region receiving $600,000 to begin capital telecommunications improvements in 1988-89. (See also paragraph 13.72 for our observations on communications in the Atlantic.)

13.150 The Region is currently seeking innovative approaches to maintaining both boats and radio equipment and carrying out training programs for operating them that minimize the effect on person-years. (Our concerns about training were also expressed in paragraph 13.75 of this chapter.) We will continue to assess these and other capital management issues periodically.

13.151 **Economy and efficiency of in-season salmon management - data collection and analysis.** In 1986, we noted that collecting and analyzing data while the salmon fishery was in progress was a highly labour-intensive task, and was conducted primarily on a manual basis. There were insufficient attempts to explore ways of reducing processing time and a lack of consideration of the use of electronic data processing equipment. We recommended that the Region examine more economical and efficient ways of collecting, storing and processing in-season information.

13.152 The Department reports significant progress toward integrating computers in the fisheries management process at all levels. Hand-held field computers, which incorporate data collection, licencing verification and enforcement information, were pilot tested and have now been incorporated in the normal operational activities of two sub-districts. Local computer systems, which facilitate the capture of catch and escapement data and management decisions, will soon be in all district and sub-district offices. Also, the Region is testing a system of direct entry of sales information into field computers by commercial fish buyers.

13.153 The Region intends to continue to improve and expand its electronic data processing capabilities, thereby addressing the concerns raised in our 1986 audit. We recognize this progress. However, it would be premature for us to attempt to evaluate the success of these initiatives now.

13.154 **In-season planning initiatives.** Our 1986 audit noted that the management of the in-season fishery was weakened by an ineffective planning system. We recommended that the Region establish, Region-wide, a planning approach for determining the resource requirements of each fishery, including defining objectives, priorities and activities contributing to these priorities; identifying and allocating resources accordingly; and monitoring and evaluating achievements.

13.155 Once again, the Region reports good progress in this area. However, it believes that more work remains to be done before it is satisfied with the planning process. For fish stocks, the main objectives and priorities, as well as the activities contributing to their achievement, are stated in the stock management plans such as the Salmon Stock

Management Plan, for which pilot level consultation and implementation is being undertaken in 1988.

13.156 The current work planning process requires that resources needed for each deliverable be clearly identified and each result linked to branch and regional priorities. Also, a monthly performance reporting system was put into place to monitor actual results against plans and identify variances from stated objectives.

13.157 The Region is concerned that, at the working level, work planning may have become too detailed and time-consuming, and is working toward streamlining the process to ensure that it is useful to managers. We will continue to monitor these ongoing efforts.

Salmonid Enhancement Program

13.158 **Costs and benefits of SEP.** In 1986, we observed that the Region was not moving quickly enough to collect and analyze information needed to review the cost-effectiveness of SEP enhancement activities, such as actual fish returns. Measures of program costs and actual benefits were not in place, and we recommended that the Region assess and report on such measures.

13.159 Subsequent to our audit, the Region arranged to have a program evaluation framework of SEP prepared. This is currently in its final draft stage, awaiting executive approval. However, it has been accepted by the Region, which is now collecting data to meet its requirements. This will require data collection and analysis of costs and benefits up to the key reporting year of 1991-92. In the meantime, the Region states that most data-gathering mechanisms are in place, and that it is doing early analyses of some returns based on an original time-series of data.

13.160 SEP and the measurement of its costs and benefits will continue to be important to the Pacific Region in the future. The Region has acted positively in addressing our recommendation. However, we will have to reassess the results of these efforts as the data are accumulated and reported.

Managing Regional Resources

13.161 **Contracting.** In 1986, we found that contracting was not being managed in accordance with government guidelines, particularly in relation to contracting for hatcheries work. We recommended that the Region and the Department reassess the approach of using contractors for hatchery work.

13.162 The Region has re-examined its contracting-out practices and believes its approach is the most practical and cost-effective, within the constraints of available person-years. Contracting allows the Region to meet seasonal workload requirements and, also, address other government objectives such as regional employment. Based on our review, we are satisfied that the Region has taken appropriate action on our recommendation.

13.163 **Planning and budgeting.** We observed in 1986 that the planning and budgeting system in place did not allow the Region to manage its regional resources to ensure that program requirements were being achieved at reasonable costs. We recommended that the Region improve the operational planning process by specifically tailoring it to program management requirements.

13.164 The Region has made improvements in its cyclical planning framework, which is followed in preparing priorities and work plans for the Region. It reports that it is continuing to make efforts to improve the linkages between sector and regional priorities. Area Planning Committees are setting priorities for each area based on a further refinement of regional and branch priorities.

13.165 Progress has been made, but considerable work remains to be done on defining a "minimum program". By determining the activities that are most necessary, the Region can best compete for scarce resources. Also, it will be looking for ways to make the work planning process less onerous on field staff and more efficient overall. As well, the Region is concerned about the lack of progress on a financial management information system that supports the planning process. The new Department-wide system may alleviate these concerns.

13.166 Planning is an ongoing activity requiring continuous review and change. We will continue to monitor the Region's efforts to improve its planning systems.

Summary

13.167 Overall, the management of the Pacific Region has made progress, resolving or addressing the observations and recommendations from our 1986 Report, with noticeable improvements to information and management systems. A number of the areas, by their very nature, will require continued attention by management and will be reviewed by us during the normal cycle of our audits.

DEPARTMENT OF INDIAN AFFAIRS AND NORTHERN DEVELOPMENT

DEPARTMENT OF INDIAN AFFAIRS AND NORTHERN DEVELOPMENT

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14

DEPARTMENT OF INDIAN AFFAIRS AND NORTHERN DEVELOPMENT

Main Points

The administration of Indian Affairs is one of the most complex areas of public administration, involving difficult historical, constitutional, federal-provincial and social issues. (paragraphs 14.1 to 14.9)

The Department of Indian Affairs and Northern Development (DIAND) does not have a clear legislative mandate for funding or delivering Post-Secondary Education Assistance and Social Development services. Thus, roles and responsibilities are unclear and there is no real accountability link between the Department and Parliament for these activities. (14.19 to 14.27)

This absence of a clear legislative mandate has resulted in misunderstanding and uncertainty among Indians about the purpose of these activities and the services to be delivered. (14.28 to 14.31)

The Department requires a clear legislative mandate which defines the responsibilities of Canada with respect to the delivery and funding of services to Indians. Such a mandate would facilitate the negotiation of agreements between Canada, the provinces and Indian bands, and establish the accountability framework that is now missing. (14.32 to 14.35)

The Department has improved its systems and procedures in the areas of Housing and Community Capital Facilities. (14.89, 14.90)

For over 20 years we have reported that the Department cannot assure Parliament that funding provided to bands through contribution agreements and other funding arrangements is used for its intended purposes. (14.95 to 14.98)

There remains a fundamental need for a more practical approach to funding bands, which would include a realistic monitoring role for DIAND. (14.118 to 14.122)

DEPARTMENT OF INDIAN AFFAIRS AND NORTHERN DEVELOPMENT

Introduction

Federal Responsibility for Indians

14.1 The mandate for providing services to Indians stems primarily from the Indian Act and the Department of Indian Affairs and Northern Development Act, 1970. The Department administers reserve lands and Indian moneys, and provides for the delivery of basic services (such as education, social assistance, housing and community infrastructure) to status Indian and Inuit communities.

14.2 Registered Indians in Canada numbered 388,000 at 31 December 1986 (about 1.5 percent of the Canadian population). Of these, 264,000 (68 percent) lived on reserve lands.

14.3 There are 592 Indian bands, with an average "on reserve" population of 450. Reserves are dispersed across the country and many are geographically isolated in northern areas with limited economic potential (17 percent have no year-round road access).

14.4 Between 1975-76 and 1986-87 the budget of the Indian Affairs Program increased from $460 million to $1.7 billion. Discounting for inflation, this represents a real growth of 68 percent. By comparison, the registered Indian population increased by 32 percent.

14.5 Several factors can be expected to contribute to a continuing strong demand for federal services to Indians. The annual growth rate of the Indian population – at 2.2 percent – is higher than the rate for all Canadians. Moreover, a 1985 amendment to the Indian Act (Bill C-31), designed to assure equality of treatment to men and women, may reinstate as many as 80,000 to 100,000 people as status Indians.

14.6 Although the current level of federal expenditures for Indians is significant, social indicators show that Indians typically face worse living conditions than other Canadians. For example, life expectancy for Indians at birth is about 10 years shorter than the Canadian average.

14.7 A March 1988 Information Sheet from the Department summarized the situation as follows:

> Indian living conditions have improved significantly in the last quarter century. Although much has been accomplished, more remains to be done. Indians are still among the most disadvantaged of all Canadians. Nevertheless, the momentum for change established over the last 25 years is clear and strong.

14.8 In recent years a dramatic change has taken place in the delivery of services to Indian communities. By 1986-87, 64 percent of the Indian Affairs Program expenditures were managed by Indian bands, tribal councils and associations, compared with 39 percent in 1979-80 (see Exhibit 14.1).

14.9 The trend toward Indian administration of Indian services is supported by current Department priorities, emphasizing Indian control of the delivery of services and downsizing of Department staff as responsibilities are transferred.

1986 Comprehensive Audit

14.10 Our 1986 Report was highly critical of the management of Indian lands, estates and moneys. In response to our findings, the Department undertook several initiatives. The Minister asked the President of the Treasury Board to conduct a detailed study of the Lands, Revenues and Trusts sector of DIAND. The Department assumed responsibility for Phases II and III of the study in January 1988 and expects to substantially complete Phase II by December 1988. The Lands, Revenues and Trusts sector was strengthened through a reallocation of person-years from elsewhere in the Department, the appointment of two new directors general and the development of officer training programs.

14.11 On 28 March 1988 the Minister of Indian Affairs and Northern Development introduced in the House of Commons Bill C-123 to amend the Indian Act. The proposed amendments are intended to clarify the responsibilities of the Minister with respect to Indian minors' trust accounts and to increase a spouse's preferential share of an estate when a person dies without a will. These proposed amendments deal with issues which were raised in our 1986 audit.

14.12 In response to our findings on elementary and secondary education, the Department stated that it was waiting for a study by the Assembly of First Nations before revising its policies. This study was released in May 1988.

14.13 Regarding comprehensive land claims, the Department's new comprehensive claims policy, approved in December 1986, requires that final agreements be accompanied by implementation plans. The Department plans to issue guidelines in 1988-89 on the procedures to be followed by claims negotiators in developing implementation plans.

14.14 The Department provides regular status reports on its response to our 1986 comprehensive audit to the Standing Committee on Public Accounts, as requested in that Committee's Fourth and Fifth Reports, issued in 1987.

Exhibit 14.1

ADMINISTRATION OF INDIAN AFFAIRS PROGRAM

	1979-80		1986-87	
	$ 000s	**%**	**$ 000s**	**%**
Administered by bands	276,956	38.5	1,092,086	64.1
Administered by provinces	32,699	4.6	218,972	12.8
Administered by the Department	409,271	56.9	393,968	23.1
TOTAL	718,926	100.0	1,705,026	100.0

Source: DIAND

Scope of this Audit

14.15 This year we examined three major activities within Indian Services:

	1987-88 Forecast Expenditures
- Post-Secondary Education Assistance	$111 million
- Social Development (Social Assistance, Child Welfare, Adult Care)	$409 million
- Housing and Community Capital Facilities	$309 million
	$829 million

Source: 1988-89 Estimates, Part III

14.16 In addition to the above activities, we examined, in general, arrangements where funds are transferred to Indian bands to deliver services. In particular, we looked at the use of contribution agreements and alternative funding arrangements.

14.17 To examine services administered by the 592 Indian bands, we selected a representative sample of 30 bands. We then reviewed the Department's procedures for monitoring these transferred responsibilities.

14.18 We relied on the work of the Departmental Audit Branch in areas where their reviews had preceded or were complementary to our examination.

Mandate and Jurisdiction

14.19 In our 1986 Report we commented on the imprecise nature of the Department's mandate with respect to its fiduciary responsibilities regarding reserve lands and Indian moneys. This year we looked at the Department's mandate with respect to Post-Secondary Education Assistance and Social Development. Our objective was to determine whether the Department's mandate in these areas was clearly defined and provided specific authority for these activities.

14.20 Again, we found serious problems with both mandate and authority. Although these activities (or programs, as they are often referred to) have been in existence for a number of years, the Indian Act is silent with respect to the provision of either form of assistance.

14.21 Under the Constitution Act, 1867, Parliament has the power to make laws in relation to Indians and lands reserved for Indians. This power has been interpreted to mean that Parliament may make laws in respect of Indians living on and off reserve if those laws "in substance" are aimed at Indian concerns. Pursuant to this power, the Indian Act provides for the creation of a number of programs addressing Indian concerns on reserves such as Indian estates, education and management of property.

14.22 However, the Act contains no mandate for activities such as Post-Secondary Education Assistance, Child Welfare, Social Assistance, Adult Care or Individual and Family Care. Authority for the Post-Secondary Education Assistance and Child Welfare activities is derived from annual Appropriation Acts only, while authority for the remaining Social Development activities is not specifically granted anywhere in legislation. Exhibit 14.2 shows the legislative mandate for specific Indian services.

Consequences of Imprecise Mandate

14.23 We are concerned about programs authorized only by Appropriation Acts because, on several occasions, speakers of the House of Commons have ruled that Appropriation Acts are not to be used to originate programs. In the opinion of the Speaker in 1977,

> the government receives from Parliament the authority to act through the passage of legislation and receives the money to finance such authorized action through the passage by Parliament of an appropriation act. A supply item... ought not, therefore, to be used to obtain authority which is the proper subject of legislation...

Exhibit 14.2

LEGISLATIVE MANDATE - INDIAN SERVICES

Activity	Enabling Legislation	DIAND's Assumed Responsibility	Disputed Areas and Comments
Post-Secondary Education Assistance	Appropriation Act No. 3, 1987-88	Assistance for registered Indians and Inuit to attend recognized colleges and universities.	No significant disputes with provinces.
Social Development			
A. Social Assistance	No legislative base	Social Assistance funds for status Indians : (a) on reserve and (b) off reserve until provincial residency requirements are met.	Disputes with provinces over interpretation of "off reserve" and residency requirements. Complicated jurisdictional arrangements such as the Motherwell-Hunter line in Alberta.
B. Child Welfare	Appropriation Act No. 3, 1987-88	Funding for prevention, protection, adoption and family support services to status Indians: (a) on reserve and (b) off reserve until provincial residency requirements are met.	Formal agreements on funding and delivery of services do not exist for all provinces.
C. Adult Care	No legislative base	Funding for homemaker services, foster care and institutional care for status Indians normally resident on reserve.	Disputes with provinces over funding for mentally and physically disabled Indians, in off-reserve institutions. Some on-reserve institutions are not licensed by the provinces.
Housing and Community Capital Facilities	Indian Act	Financial assistance to the bands for on-reserve housing and community capital facilities.	No significant disputes with provinces.

Notes:

1. Section 91(24) of the Constitution Act, 1867 confers upon Parliament the power to make laws in relation to "Indians, and Lands reserved for the Indians."
2. Section 4 of the DIAND Act states that the duties and powers of the Minister include all matters relating to Indians over which the Parliament of Canada has jurisdiction.
3. Annual Appropriation Acts provide the Department with authority to spend money on specific Indian services.
4. Provinces have the power to make laws in relation to welfare and education in the province.
5. Under the Motherwell-Hunter Agreement between Canada and Alberta, social services are provided and funded based on geographic location and employable/unemployable criteria.

14.24 Our view has been confirmed by independent legal counsel. Counsel have advised that, although creating spending programs not otherwise authorized by statute through Appropriation Acts is not...

> in and of itself, unlawful, the concept of creating major legislative spending programs by means of a short reference in the Estimates appended to annual Appropriation Acts, comes very close to jeopardizing the integrity of the system of Parliamentary control over the spending authority of the Executive. This method of proceeding involves conferring a discretion of indeterminate magnitude upon the Executive without any real accountability to Parliament for the content of such programs (since there are no legislative standards by which such programs can be measured). What is more, the group most affected by the legislation, i.e., the Indian people, are left with little, if any, concrete understanding of their entitlement under such programs. While these factors do not necessarily, in and of themselves, render such programs unlawful, they do not reflect the highest standards of Parliamentary tradition.

Officials of the Office of the Comptroller General informed us that, as a result of the 1977 Speaker's ruling, the Government no longer uses Appropriation Acts to obtain new program authorities.

14.25 Our concern about the Social Assistance and Adult Care and Individual and Family Care activities is more pronounced, as we could find no specific legislative authority for them, even in the Appropriation Acts. The only conclusion to be drawn is that authority for these activities is lacking.

14.26 Through enabling legislation Parliament confers on a Department an obligation to do certain things. In the absence of enabling legislation, as is the case for the above services to Indians, DIAND's obligations are not defined and therefore it cannot be held accountable to Parliament.

14.27 The absence of a clearly defined federal mandate for Social Development activities has resulted in uncertainty regarding the roles and responsibilities of the federal and provincial governments with respect to the delivery and funding of social services to Indians.

14.28 Under the Constitution Act, provincial governments have the power to make laws in relation to the provision of welfare services in their respective provinces. All provinces have enacted laws and developed programs to assist those in need. However, provinces are of the opinion that, although they have jurisdiction in this area, Indians are a federal responsibility and the federal government should therefore fund the delivery of these services, at least to Indians living on reserve.

14.29 The federal government has accepted responsibility for funding social services to Indian communities because of the reluctance of most provinces to do so. The money required to "fill the gap" now amounts to $400 million annually. DIAND funds social services to Indians through myriad agreements with bands, provinces and territories. As a result, there are inconsistencies in services available to Indians, both among and within provinces, and in service and funding standards, reporting requirements and federal-provincial cost-sharing arrangements.

14.30 The following examples illustrate the problems and uncertainties that arise:

> Social Assistance: The delivery and funding arrangements for social assistance to Indians vary from province to province. Status Indians leaving their reserves have to meet provincial residency requirements (usually a year) before qualifying for provincial programs. Rules are complicated and subject to interpretation.
>
> Adult Care: The main area of dispute is responsibility for the care of mentally and physically disabled Indians in institutions off reserve. Because of a lack of policy in this area, funding of adult care services is inconsistent both among and within provinces.

The consequences of these situations are uncertainty for the governments involved and for Indian people.

14.31 The imprecise nature of these arrangements has precipitated disputes between the Department and the provinces regarding funding responsibility for certain social services. As of 31 March 1988, claims against the federal government were more than $70 million.

14.32 The lack of clearly defined mandates for Social Development and Post-Secondary Education services has been a contributing factor to serious problems noted in these sections of the chapter. Until the parameters of the Social Development and Post-Secondary Education activities and the roles and responsibilities of the Department are well defined, it will be very difficult to properly manage and account for them. In our opinion, the type of direction required can best be achieved through entrenching such activities in substantive legislation.

14.33 A legislative mandate would provide the foundation for the Department's policies regarding Indian services and for its accountability to Parliament. Most importantly, it would help Indian people understand what services and benefits they have a right to. In the case of Social Development activities, a legislative mandate would facilitate defining and formalizing the responsibilities of Canada, the provinces and territories and Indian bands in delivering and funding these services.

14.34 We recognize the difficulties in enacting legislation relating to Indian Affairs, and the length of time required to do so. Interim initiatives are therefore essential and, we believe, practical. As described in the remainder of this chapter, they include developing policy, defining delivery and funding responsibilities and the role of bands, and telling Parliament the results achieved.

14.35 **The Department of Indian Affairs and Northern Development should seek a clear legislative mandate for funding and delivering services to Indians in the areas of Post-Secondary Education Assistance and Social Development.**

Post-Secondary Education Assistance

14.36 In October 1977 Treasury Board approved the Post-Secondary Education Assistance (PSEA) program. The purpose of the program, as stated in Circular E-12, is to "encourage Registered Canadian Indians and Inuit to acquire university and professional qualifications so that they become economically self-sufficient and may realize their individual potential for contributions to the Indian community and Canadian society."

14.37 Students funded through the program receive assistance, in the form of a grant, for tuition fees, books and supplies. Full-time students are eligible for additional assistance to cover living expenses for themselves and their children. Except for certain services, such as shelter allowance, the level of assistance does not depend on the student's income or on the income of his or her parents or spouse.

14.38 The estimated enrolment for the program in 1977 was 3,300 students. In 1987-88 there were 14,447 students being assisted at a forecast cost of $111 million.

Program Management

14.39 About 40 percent of assistance is delivered by the Department's regional and district offices; bands and tribal councils deliver the remaining 60 percent.

14.40 **Department-administered PSEA.** When the Department delivered the assistance, we found that practices differed from one region to the next. As a result, there is no assurance that students in similar situations will receive a level of funding consistent with Circular E-12. For example, assistance for commuting is available in Ontario and Alberta but is provided only in special circumstances in Quebec and Saskatchewan; students in a one-week course were funded in Ontario while in British Columbia the practice is not to assist students registered in courses of less than a year. These differences have been known to headquarters for some time but action has not been taken to achieve more consistency and fairness.

14.41 In addition, in the 70 individual student files we examined in three regions, we found many errors. There were inaccurate payments, funding for ineligible students and courses, and lack of documentation to support the payment of shelter and child care allowances. Also, there was incomplete historical information on individual students to ensure, for example, that the time limit for assistance was not exceeded.

14.42 **Band-administered PSEA.** For the band-administered portion of PSEA, we reviewed the Department's procedures for monitoring transferred responsibilities to the 17 bands in our 30-band sample who either administered the related contribution agreement or were members of a tribal council that did.

14.43 We noted variations in the conditions placed on bands under these contribution agreements. For example, in some districts, adherence to Circular E-12 is required, while in others it is not. Consequently, the Department has no assurance that band members are receiving the assistance they are eligible for according to Circular E-12.

14.44 We also noted wide variations in the manner in which the Department exercised its responsibility for monitoring these agreements. Monitoring practices varied from region to region, ranging from periodic visits to band offices in Alberta and British Columbia to virtually no visits in Manitoba.

14.45 In summary, DIAND has not defined clearly whether bands and tribal councils, in taking charge of PSEA for their members, are assuming a management role (with the authority to change the rules) or only an administrative role (applying the program rules as defined by the Department). To ensure that PSEA is properly administered, the Department must provide bands with a clear and consistent policy framework. To date this has not been done.

Budgeting

14.46 Since inception, the budget for PSEA has been adjusted as necessary to meet student demand. The Department did not attempt to project its annual financial needs accurately, relying instead on supplementary funding. As a result, the total funding available for PSEA was never known with certainty by regional staff and the bands at the beginning of a year.

14.47 For example, in the 1986-87 Main Estimates the budget for PSEA was $69 million. To provide for the actual cost of the activity in that year, an additional $17 million was obtained through Supplementary Estimates and another $10 million was reallocated from other activities.

14.48 In 1987-88 the Department imposed a fixed budget for PSEA and adjusted program operations to ensure that the expenditures would not exceed that amount. This meant that, once the current year budget had been committed, remaining applications for financial assistance were deferred to future years. As a result, students had to seek alternative sources of support or postpone their education plans.

Accountability and Management Information

14.49 PSEA is authorized only through annual Appropriation Acts and therefore lacks a clearly defined legislative mandate. As a result, the direction of the activity has been left largely to the discretion of the Department. The Department's accountability to Parliament and to the public, beyond standard financial reporting, is not clear. At no time, however, has the Department sought to clarify its mandate from, or accountability to, Parliament for Post-Secondary Education Assistance.

14.50 In the absence of a clear mandate, the objectives of PSEA have shifted over time from encouragement to acquire university and professional qualifications to encouragement to participate in a variety of post-secondary courses of study. Consequently, the Department has had difficulty in developing indicators to measure either the achievement of program objectives or performance. The participation rate – the number of participating students of a defined age over the total population of that same age group – is the only performance indicator in place.

14.51 According to DIAND, in 1985-86 the participation rate of Inuit and Indians between the ages of 19 and 24 was less than one-third that of all Canadians (7.1 percent compared to 24.5 percent). However, it should be noted that PSEA has encouraged mature students to return to school; nearly 50 percent of the students assisted under the program are older than 25.

14.52 Good information is needed for managers to monitor results of PSEA. However, the Department does not systematically collect or publish information on graduation rates and other relevant statistics. This concerns us because these statistics could be used in managing PSEA and in determining its future direction. Moreover, these statistics would provide valuable information to Parliament in Part III of the Estimates. While the Department has made several attempts to develop and implement an information system to meet these basic needs, it has not yet succeeded in doing so.

14.53 **For the Post-secondary Education Assistance program the Department of Indian Affairs and Northern Development should:**

(a) where assistance is Department-administered

- **ensure consistency with program policies;**
- **maintain proper documentation and accurate, up-to-date information on individual applicants;**

(b) where assistance is band-administered

- **define the role and responsibilities of bands and ensure consistency with those policies;**
- **specify in the terms and conditions of contribution agreements the operational statistics that bands should provide to the Department; and**

(c) in both cases

- **maintain relevant, basic program information such as graduation rates, number of graduates by field of study and employment statistics.**

Social Development

14.54 The Social Development activity provides financial assistance and welfare services to eligible Indians living on reserve. The position of the Department is that status

Indians living off reserve should qualify for and receive assistance and services from their communities and provinces on the same basis as other residents.

14.55 The total cost of the Social Development activity was forecast at $409 million for 1987-88. This includes payments of approximately $50 million for social services to status Indians living off reserve who have not met provincial residency requirements for assistance.

14.56 Our examination covered three areas: Social Assistance, Child Welfare and Adult Care. Exhibit 14.3 shows specific services provided, methods of delivery and funding arrangements. Exhibit 14.4 shows expenditure trends.

A. Social Assistance

14.57 Social Assistance provides funds to single persons and heads of families to meet basic needs such as food, clothing and shelter as well as certain special needs such as essential furniture and appliances. The Department generally uses provincial eligibility criteria and payment rates for this program.

14.58 Given the economic conditions on many reserves, the percentage of the on-reserve Indian population receiving Social Assistance is much higher than the rate for all Canadians (44 percent compared with 8 percent in 1986-87). Forecast expenditures were $304 million for 1987-88.

14.59 Social Assistance administration includes assessing eligibility, computing payment and issuing cheques to entitled recipients. Some counselling services are also provided. On reserve, 80 percent of bands administer their own programs with funding provided by DIAND through contribution agreements. The balance of the on-reserve assistance is administered by DIAND or, in certain cases, by the province.

Budgeting

14.60 Budgeting for Social Assistance begins with an estimate by district offices of needs, by band, for the coming year. The information is then consolidated, forming the Social Assistance database. This is reviewed and challenged by the regional and headquarters levels of the Department before it is presented to Treasury Board for review and approval of an amount for DIAND's Main Estimates. For many years, the Main Estimates amount has been far below the actual costs of Social Assistance, forcing the Department to approach Parliament for Supplementary Estimates later in the fiscal year.

14.61 We reviewed the budgeting process and found that, in the aggregate, the estimate made by district offices was quite accurate (within three percent) when compared to actual costs for the past three fiscal years. However, these initial estimates were reduced at the regional, headquarters and Treasury Board levels before a Main Estimates amount was approved.

SOCIAL DEVELOPMENT SERVICES FOR STATUS INDIANS

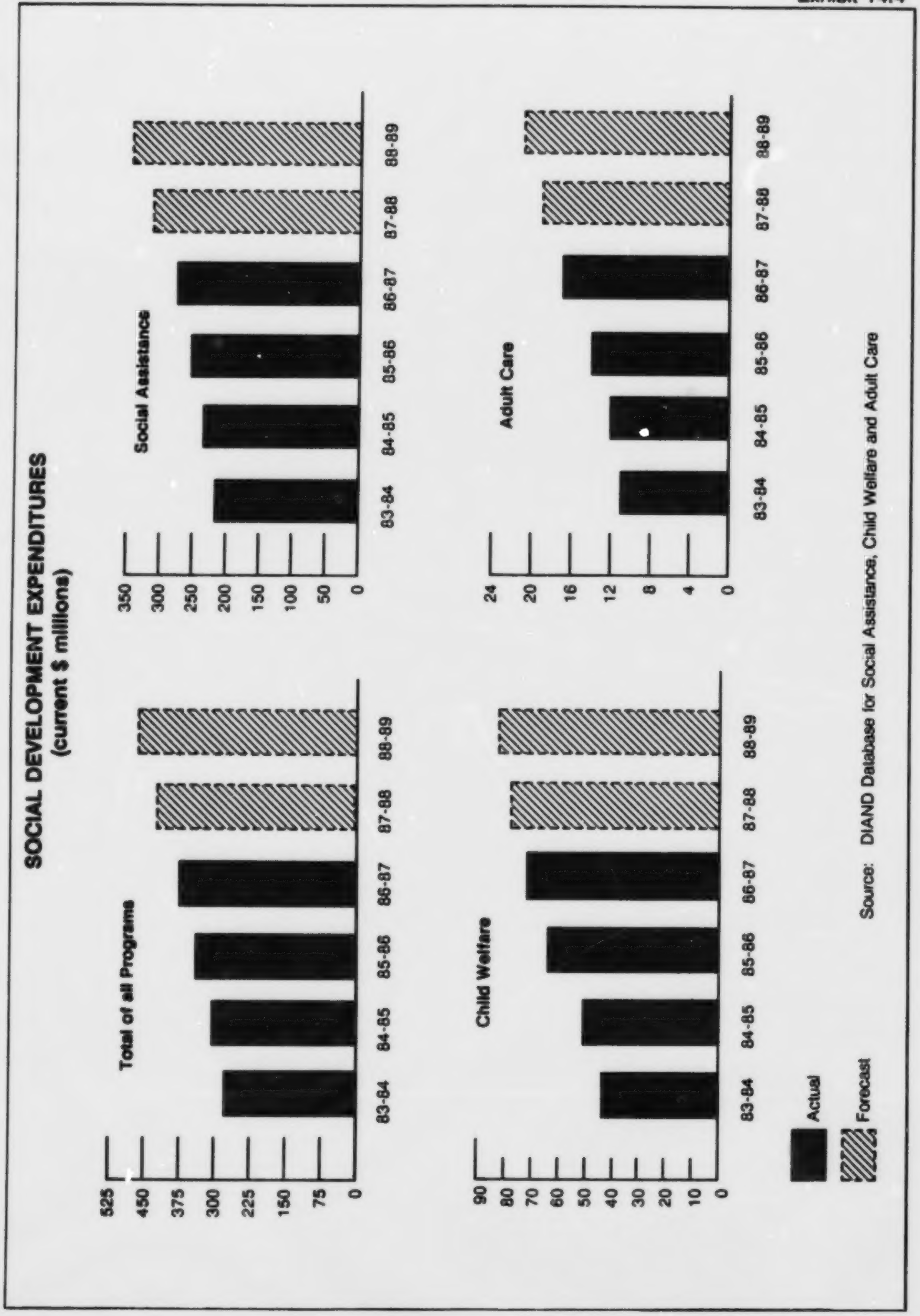
Services Provided	**Delivery Arrangements**	**Funding Arrangements**
A. Social Assistance Social Assistance payments for basic needs (food, shelter, clothing) and special needs	On reserve - 80% band - administered (86-87) - Provinces : Ontario and Alberta (Motherwell-Hunter Agreement) - DIAND : balance	On reserve - Bands: contribution agreements, with reimbursement of actual allowable costs - Ontario: 1965 agreement; long-term assistance provided by Ontario under Family Benefits Act with 50% recovered from Canada Assistance Plan - Alberta: Motherwell-Hunter Agreement - DIAND: direct payments to individuals (grants)
	Off reserve - Provinces after status Indian meets residency requirement - Alberta : Motherwell-Hunter Agreement	Off reserve - Provinces pay after status Indian meets residency requirement. - Alberta: may be paid by DIAND under Motherwell-Hunter Agreement (geographic and employable/ unemployable criteria) - Manitoba: DIAND reimburses province for payments ($16 million a year) - Saskatchewan: in the Northern Administrative District DIAND pays for all status Indians

Exhibit 14.3

SOCIAL DEVELOPMENT SERVICES FOR STATUS INDIANS

Services Provided	Delivery Arrangements	Funding Arrangements
B. Child Welfare		
Prevention, protection, adoption and family support services	On reserve - Services delivered by provincial child welfare agencies, Indian agencies or a combination of the two - 308 bands (55%) delivered some services in 1986-87.	On reserve - Bands: contribution agreements - DIAND reimburses provincial and Indian child welfare agencies - Ontario: 1965 agreement
	Off reserve - Provincially-mandated child welfare agencies	Off reserve - Provinces pay after status Indian meets residency requirement
C. Adult Care		
(a) Homemaker services - meals and assistance with household tasks	On reserve Bands Off reserve Not applicable	On reserve Bands: contribution agreements Off reserve Not applicable
(b) Institutional care - supervision or nursing care for the aged, mentally or physically disabled	On reserve Bands: only 2 of 11 institutions are provincially licensed. Off reserve Provincial or private agencies	On reserve Bands: contribution agreements Off reserve - Partial to full reimbursement of costs in five provinces/ territories - Formal contractual arrangement do not exist for all provinces or private operators - Disputes with provinces over delivery and financing of care for mentally and physically disabled

Exhibit 14.4



SOCIAL DEVELOPMENT EXPENDITURES
(current $ millions)

Source: DIAND Database for Social Assistance, Child Welfare and Adult Care

14.62 Moreover, before allocating approved funds, headquarters and the regions often reserved a portion for contingencies. Consequently, the amount allocated to each band at the start of the fiscal year was usually well below the previous year's actual costs.

14.63 The result is that Department managers and band administrators do not use their Social Assistance budgets for planning and control purposes because they are not realistic. Bands expect, and are entitled, to be fully reimbursed for the actual costs of Social Assistance paid to their on-reserve members.

14.64 For 1988-89, we were informed that the Department has stopped this practice of reserving funds. All Social Development program dollars are to be included in a band's initial budget allocation.

Band-administered Social Assistance

14.65 In reviewing Social Assistance for the 30 bands in our representative sample, we examined the arrangements under which the program was administered by bands authorized to do so.

14.66 **Program delivery.** From our review of documentation in field offices, we found:

- no evidence of individual band members complaining to Department officials that they had been denied Social Assistance benefits to which they were entitled;
- only isolated errors with respect to the determination of eligibility and entitlement; and
- only minor adjustments from Department verification of monthly reimbursement claims submitted by the bands.

14.67 We concluded that the bands in our sample administered Social Assistance in accordance with basic program requirements. On one occasion when a problem did occur, the Department responded quickly to ensure that regular payments continued.

14.68 **Program review.** The Department monitors the delivery of Social Assistance by bands to ensure that the terms and conditions of contribution agreements are adhered to. The periodic program review effort also offers an opportunity to provide training and support to band welfare administrators. For bands in our sample, we examined the process for conducting these program reviews, as well as the reports prepared.

14.69 We found that objectives for program reviews were not well defined and little information was available to Department staff on how they were to be carried out. No reporting standards existed and the historical record of results was not well documented. Overall, the program review effort was poorly planned and conducted. With program transfers to bands such a high priority, the Department has chosen not to emphasize program or compliance reviews at this time.

Department-administered Social Assistance

14.70 In 1986-87, the Department administered $65 million in Social Assistance payments to individuals and families. These payments were made to Indians whose bands do not administer a Social Assistance program, or to those who did not meet provincial residency requirements.

14.71 Recent internal audit reports on Department-administered Social Assistance have found problems with the lack of an appropriate segregation of duties in assessing eligibility, computing payment and issuing cheques in some offices. This, combined with the lack of compensating controls such as case rotation and supervisory review, has created the opportunity for incorrect payments of assistance to occur.

B. Child Welfare

14.72 Through the Child Welfare program, DIAND provides funding for the delivery of child welfare services to Indian children and parents residing on reserves. Services funded include protection, adoption, family support, counselling, day-care and homemaker services.

14.73 Increases in federal spending on Indian child welfare over the past decade are due to the reluctance of most provinces to develop or expand services on reserve. Also, many Indian communities were gaining access to these essential social services for the first time. In recent years, bands have sought to provide more culturally appropriate services to their members (both on and off reserve). Indian-operated child welfare agencies now service 32 percent of all bands. Moreover, 23 percent of bands receive funding from DIAND to deliver non-statutory child and family services.

14.74 In 1987, there were approximately 140,000 Indian children aged 18 and under. Of these, 102,000 (73 percent) lived on reserve. Approximately 6.4 percent were in care outside the homes of their parents. The Department's Child Welfare costs were forecast at $78 million for 1987-88.

Service Delivery

14.75 Because of Canada's special relationship with Indian people, the federal government (through the Minister of Indian Affairs and Northern Development) has accepted responsibility for ensuring that Indian children and families have access to child welfare services. To this end, DIAND reimburses provincial and territorial governments and accredited child care agencies (both Indian and provincially operated) for the cost of child welfare services to Indian children and parents residing on reserve.

14.76 Arrangements vary by province, and in some provinces Indians are not entitled to a whole range of services that may be available to Indians in another province. In Saskatchewan, for example, no preventive services, which Indians view as the most valuable, are available to Indians because they are not part of that province's service package. This is a direct result of federal recognition of provincial jurisdiction and of adhering to provincial standards for child welfare. In addition, because Child Welfare agreements with individual bands within a province vary, all bands in that province may not be entitled to the same range of services or the same level of funding.

Program Management

14.77 There is no real policy base for DIAND's Child Welfare program. Since its inception in the 1950s, the program has been largely reactive. Arrangements with provinces, bands and tribal councils have come about as a result of the demands of these groups rather than as part of a comprehensive Child Welfare policy or program. The Department recognizes in its Child Welfare Program Circular that "formal agreements are necessary for channelling, controlling, administering and monitoring child welfare services to Indian people". Agreements have been developed individually in different regions of the country and with different groups within regions. This has resulted in a complex network for service delivery and in 308 agreements which cover approximately 55 percent of all bands.

14.78 The lack of policy and procedures has meant that services covered, service and funding standards, reporting requirements, and the structures of federal-provincial cost-sharing arrangements all vary from province to province. This complex series of arrangements has made overall management of the program very difficult, if not impossible. In our opinion, many of these management difficulties can be traced back to the lack of a clear legislative mandate for the Child Welfare program.

14.79 Most important, the Indian population is unsure what services it is entitled to and who should deliver and fund them. An April 1988 DIAND Communiqué on Indian Child Welfare states:

> There is no mutual understanding of the roles and responsibilities of Indian communities, provinces and the federal government. This gets in the way of resolving such issues as program design and management, standards, accountability and the working relationship among service agencies on reserve and those off reserve.

14.80 In response to Indian dissatisfaction with provincial services and increasing demands by bands to establish and operate their own child welfare agencies and programs, the Department set up a Task Force in June 1986 to address child welfare service delivery issues. The Task Force prepared useful program information such as an inventory of existing services and delivery arrangements. Unfortunately, the study delayed important decisions on Indian Child Welfare for almost two years because a moratorium was placed on the negotiation of new agreements with bands.

14.81 We found Indian child welfare to be an area of great complexity and sensitivity. In the past decade many changes have taken place in the delivery arrangements for child welfare services as bands have begun administering these services. It is critical that future changes and anticipated growth in child welfare services be well managed within an appropriate policy and program framework.

C. Adult Care

14.82 Adult care has been described as the "sleeping giant" of the Social Development field because of the demographics of the Indian population and the growing demand for on-reserve services. Adult care expenditures were forecast at $19 million for 1987-88. They are split between homemaker care (46 percent), institutional care (52 percent) and foster care (2 percent).

14.83 Adult care services include homemaker services, meals and assistance with household tasks, and some supervision or nursing care for those in foster homes or institutions. The activity is directed primarily toward the aged and the mentally and physically disabled. Bands deliver homemaker and some institutional services on reserve.

14.84 We found serious problems in the planning and management of the Adult Care program:

- There was no planning function within the program at either the headquarters or regional level. Regions respond to specific initiatives and requests by bands, provinces and the Medical Services Branch of the Department of National Health and Welfare. However, the responses are ad hoc and unsupported by headquarters policy or program direction.
- Adult care services are not delivered on the basis of a clear policy or on an assessment of needs.
- In two regions we visited, billings for services from provincial and private institutions were not adequately reviewed before payment. Moreover, most services were provided free of charge, disregarding the requirement to assess the financial means of recipients.

14.85 The Department recognized that it lacked basic information on actual field policies and practices and therefore completed its Adult Care Inventory Study in 1987. The study identified numerous inconsistencies in adult care service levels and costs across the country.

14.86 The Department has chosen to give low priority to adult care services relative to other Social Development activities. The consequences of this decision are evident from our findings.

14.87 **For its Social Development programs, the Department of Indian Affairs and Northern Development should:**

- **develop comprehensive policy statements for each program area to provide an appropriate base for transferring responsibilities to bands, tribal councils and Indian child welfare agencies;**

- **prepare accurate projections of expenditures for Main Estimates and allocate funding to bands based on those projections;**

- **maintain up-to-date basic program information such as that prepared for the Child Welfare Task Force and Adult Care Inventory Analysis; and**

- **direct program management efforts to ensuring that field practices are consistent with existing directives and procedures.**

Housing and Community Capital Facilities

14.88 We reviewed capital expenditures for on-reserve housing and for community capital facilities (water, sanitation, electrification and roads systems, fire protection facilities and special services such as flood and erosion control). We also examined ongoing expenditures for operating and maintaining these capital assets. Total expenditures for these activities were forecast at $309 million in 1987-88; this excludes education facilities, which we reviewed in our 1986 audit.

14.89 In our 1978 Report we noted serious weaknesses in the acquisition process for capital projects (five school projects). Since then the Department has improved its systems and procedures in the capital program and is continuing its efforts to make them more efficient.

14.90 The community capital projects that we reviewed were carried out in accordance with headquarters guidelines and instructions manuals, which follow standard government requirements. In addition, the Department has a reasonable basis for allocating operations and maintenance funds to the bands. In making improvements the Department has recognized, in the planning and allocation of capital expenditures, the limitations on funding and resources available.

Funding Arrangements for Indian Services

14.91 The mechanisms used to provide funding to Indian bands, organizations and others, and the amounts involved, are shown in Exhibit 14.5. Specific Treasury Board requirements must be observed in the use of each mechanism, and a funding arrangement between the parties is usually necessary. Past studies have shown that funding arrangements with bands are complex and create a significant administrative burden for both Department and band managers.

14.92 The most common of these mechanisms is the contribution agreement, which has specific terms and conditions attached to it, including a statement of purpose and allowable expenditures, and a requirement for an accounting of expenditures and an audit. In 1987-88 the Department provided 750 organizations with $1.3 billion through more than 8,000 contribution agreements (including amendments).

Exhibit 14.5

INDIAN SERVICES TRANSFER PAYMENTS 1987-88

($ millions)

Funding Mechanism	Recipient			
	Individuals	Bands/Tribal Councils	Provinces and other	Total
Grants	106	119	2	227
Contributions	7	1,025	284	1,316
Other Transfer Payments (AFA)	-	24	-	24
Total	113	1,168	286	1,567

Source: DIAND

The Funding Process

14.93 We reviewed the 1987-88 funding arrangements in place for our representative sample of 30 bands. We identified three distinct phases of the funding process for examination: first, the negotiation of an agreement; second, the implementation of that agreement; and third, the accountability review, for which we examined the most recent financial statements.

14.94 **Negotiation.** In the first phase of the funding process, we found that the major issue was funding levels, which were generally not finalized until several months into the fiscal year. In most cases, however, interim agreements were in place at the beginning of the fiscal year. The agreements that we examined, with minor exceptions, were properly approved and met Treasury Board requirements.

14.95 **Implementation.** The Department's conduct of the second phase of the funding process has been a concern of our Office over the past 20 years. We have reported continuing instances of non-compliance with contribution requirements.

14.96 This has taken two main forms: funds have been released to bands before complete documentation requirements have been satisfied; and Department staff have not monitored band operations sufficiently to ascertain whether funds are being spent only for the purposes intended and in accordance with the contribution agreement.

14.97 We found little improvement in these areas. The Financial Administration Act requires that Department managers certify that performance has been in accordance with the contribution agreement for each payment made. We found that managers commonly make payments to bands without such assurance. Program managers and financial managers told us they were very uncomfortable about authorizing many payments.

14.98 Because of planned downsizing of field staff, managers were also concerned about being able to monitor, in a meaningful way, program performance in Post-secondary Education, Social Development and Housing and Community Infrastructure programs under contribution agreements.

14.99 **Review.** All funding mechanisms require that financial statements, in a form prescribed by the Department, be provided as evidence of satisfactory program and financial management. They are to be audited by public accounting firms and provided to the Department within 90 days of the fiscal year end.

14.100 Treasury Board requires that the Department provide assurance that funds have been used for the purposes intended and that only allowable expenditures have been charged. Although each contribution agreement includes a requirement for audit, the Department does not receive this assurance through the audit process, and the external audit opinion is silent on this issue.

14.101 The Department's policy is to have audited financial statements reviewed by district and regional audit committees. The Department does not assess program performance in these reviews, since the financial statements do not contain operational statistics.

14.102 For the sample bands, we found the reviews to be deficient. They concentrated too much on accounting issues and cash management concerns, and not enough on the cause of financial difficulties.

14.103 Also, review of the audited financial statements was rarely completed in time to be useful. A conservative estimate of the time it takes to finalize the review is six months after the fiscal year-end. It is a particular concern that, on average, more than 50 days pass after the Department receives the statements.

14.104 The Funding Management Officer (FMO) plays a key role in the contributions management process and in the analysis of band financial information. These officers participate in both the negotiation of funding agreements and in the accountability exercise at the end; often they are the only continuous link in the process.

14.105 We found that many FMOs lacked proper qualifications and that their training opportunities were poor. In locations where we did find the accountability review process working well, we also found capable and motivated FMOs who were supported by their district and regional management.

14.106 As responsibilities are transferred to bands, situations arise where regions require special financial expertise. Examples are: analysis of financial statements of large bands, preparation of Financial Management Plans (FMPs) for bands in difficulty, and analysis of major band investments such as land leases. Regions need access to special financial expertise to support the work of the Funding Management Officer.

Band Deficits

14.107 Department managers do not adequately consider financial risk in implementing funding agreements. The alarming growth in band deficits indicates that many bands are having financial difficulty. As of March 1987, 45 percent of all recipients were in a deficit position, with a total working capital debt of $49 million. The Department considered 20 percent of recipients to have "serious deficits", where the organization's ability to deliver essential community services was impaired.

14.108 We found that DIAND managers have tended to view band deficits as a cash management problem. Their reaction occurs long after the fact and usually takes the form of using capital funds (most often funds for housing) to reduce the deficits.

14.109 The findings of a recent audit in one region by the Departmental Audit Branch illustrate the use of capital funds to reduce deficits. For 24 bands in the region with Financial Management Plans, $2.8 million in capital funds was used for debt reduction in the FMPs. From 1986 to 1988, 69 houses were to be foregone for this purpose. We concluded that using capital funds, for the most part for planned housing units, to reduce band debt is accepted practice in the region.

Alternative Funding Arrangements (AFAs)

14.110 In June 1986, the Treasury Board approved DIAND's proposal to enter into AFA agreements with bands which met specified eligibility criteria. The objective of introducing these new arrangements was to transfer responsibility for the design of programs and the establishment of priorities to Indian councils who are accountable to their membership for the management of resources and the development of their communities. Overall, there are fewer administrative constraints on a band's delivery of services under an AFA.

14.111 By March 1988, 6 bands and 1 tribal council (13 bands) had signed AFA agreements, and another 18 bands had entered the negotiation process.

14.112 We have two concerns with AFAs. The first is the lack of specific legislation to support and clarify the new role of the Department and the bands under these agreements. An

AFA emphasizes a band's accountability to its members, instead of to the Department, as is required under a contribution agreement. Control over how funds are spent is largely in the hands of the band council.

14.113 This raises an important question: What responsibility remains with the Minister after transferring the responsibility for program delivery to a band under an AFA?

14.114 The answer is unclear, in the absence of express legislative authority to define the terms and conditions of such transfers. Specific legislation would help clarify the situation for Indian people, bands and tribal councils, and third party interests.

14.115 Our second concern is with the actual delegation of authority by the Minister to the band council. While the Minister is free to delegate administrative responsibility, he cannot delegate a policy role.

14.116 The AFA agreements we examined do not make this distinction clear. The word "policy" is used in connection with certain band activities. It is quite possible that some confusion exists on the precise nature and limitations of a band's policy role.

14.117 Related to this last concern is a more fundamental issue. For a band to design and operate a program within the Department's broad policy parameters, a clear statement of that policy must exist. For several of the programs being transferred under AFA agreements, such policies do not exist. Accountability relationships are clearly at risk in these circumstances.

Need for Improved Management

14.118 Department and band managers share an equal concern for good financial management. However, we found that the contribution arrangements contain inherent constraints to good management. These constraints include:

- too many agreements with too many special terms and conditions, creating an administrative burden for recipient organizations and the Department;
- rigid requirements for the Department to certify program performance by the band before contribution payments for ongoing programs and services can be made; and
- restrictions on accounting for band surpluses and deficits that do not permit a reasonable level of discretion to be exercised.

14.119 Given the complexity of many contribution agreements, Department and band managers have often ignored detailed terms and conditions in order to get on with the job and deliver programs. We concluded that managers must react to an unrealistic set of requirements with respect to many funding arrangements. The rigidity of the contribution mechanism, as it is used, can act as a disincentive to good management at both the band and Department levels. Predictably, the arrangements have also caused friction between the two groups.

14.120 AFAs developed by the Department are intended to give bands greater flexibility in using funds. They may remove many of the administrative burdens and constraints to good management that we found in the existing funding arrangements.

14.121 For all funding arrangements with Indian bands and organizations, the Department should:

- **develop a financial policy framework for field officers that encourages good management of funding arrangements and eliminates existing constraints;**
- **define the purpose of, and risk associated with, funding provided to each type of recipient, and choose the funding mechanism best suited to that purpose and risk; and**
- **ensure that Funding Management Officers are well qualified and trained and that regions have access to special financial expertise to deal with complex band financial matters.**

14.122 The Department should seek a clear legislative mandate for funding bands under AFAs. This would help ensure that DIAND's responsibilities are clear, and that the delegation, indemnification and accountability features of AFAs are valid and effective.

DEPARTMENT OF NATIONAL DEFENCE

DEPARTMENT OF NATIONAL DEFENCE

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15

DEPARTMENT OF NATIONAL DEFENCE

Main Points

The Munitions Supply Program was initiated in 1978 to provide the Department with an assured wartime production capability for critical ammunition items. This production capability has not yet been identified. This has precluded DND from developing plans for achieving the strategic objective of the Munitions Supply Program and from determining how best to apply direct and indirect funding mechanisms to achieve that objective. (paragraphs 15.19 to 15.32)

The Department needs to develop a medical supply system that will provide the framework for a complete wartime capability, while also meeting peacetime needs efficiently and economically. This could be achieved by the measures recommended in our report. (15.41 to 15.49)

The Department is carrying significant amounts of ammunition stock for training above the levels authorized or required and of repairable parts that exceed peacetime requirements. It has shortages of some repairable parts. Holding inventory that exceeds requirements inflicts a cost penalty, while shortages reduce the level of operational readiness. (15.33 to 15.37, 15.60 to 15.68 and 15.104 to 15.110)

Increased management attention could be given to assessing the performance of repair contractors, carrying out audits of repair contracts, and executing warranties. (15.74 to 15.83 and 15.101 to 15.103)

The Department's Part III of the Estimates could be improved by including indicators of defence capabilities and requirements, together with indicators of peacetime performance. (15.114 to 15.118)

Revenues from rentals of married and single quarters and sales of meals are generally assessed in accordance with regulations, and are properly collected and accounted for. (15.124 to 15.130)

DEPARTMENT OF NATIONAL DEFENCE

Introduction

Requirements for Peace and War

15.1 The ability of the Canadian Armed Forces to respond adequately in times of conflict or emergency depends on a number of factors. These include the adequacy of the levels of personnel and materiel resources, including support systems and supplies; the ability of these resources to carry out their assigned tasks; the readiness of people, equipment, and systems to respond within the required time period; and the sustainability of the Forces at an acceptable level of wartime effort for as long as is needed.

15.2 The performance of the Department, in terms of economy and efficiency of operations, depends to a large extent on the adequacy of the systems and practices used to manage these resources. Most of these systems and practices serve both peacetime and wartime requirements. The challenge, therefore, is to design them to meet the requirements of wartime efficiency and effectiveness while ensuring adequate levels of economy and efficiency in peacetime.

Earlier Audit Reports that Dealt with DND

15.3 This chapter represents a cycle in our ongoing comprehensive audit of the Department of National Defence. In our first cycle, in 1982, we reported on our audit of the Department's overall management systems.

15.4 In 1984 we carried out more detailed reviews of capital projects, major management systems, and corporate planning and feedback. The chapter contained a number of recommendations intended to improve certain aspects of project management and planning, as well as several calling for an underlying force structure plan for the longer term, against which these projects could be planned. We also suggested that steps be taken to integrate the various feedback mechanisms into a consolidated report on military capability.

15.5 In 1987 we published two chapters on DND. One dealt with Major Capital Projects: in addition to restating some concerns raised in 1984, we called for greater consistency in the areas of payments, competition and warranties. The other discussed the Department's Materiel Support System – the system used to procure, maintain and distribute the physical assets required by the Forces during peace and war. Our general assessment was that neither the materiel support system nor the logistics framework was suitably developed for sustained conflict and that, for many of the same reasons, the supply system exhibited significant economy and efficiency difficulties in peacetime. We made a number of recommendations in areas where improvement was needed.

The Focus of this Chapter

15.6 This Chapter focusses on three areas in the Department of National Defence that deal with both peacetime and wartime requirements. The first is the Materiel Support system that was described in our 1987 Report, this time addressing new topics that were not dealt with there in detail – combat supplies, maintenance and quality assurance. The second area is reporting to Parliament, which includes DND's procedures for reporting capability levels, resource requirements and past performance. It also covers DND's efforts in response to earlier suggestions for improvements in reporting on major capital projects. The third is revenues, which we audited for compliance with government and departmental guidelines and policies.

Materiel Support

Wartime Logistics Requirements and Planning

15.7 Although military materiel management must cater to the unique requirements of military operations, and in peacetime must include elements of preparedness for war, the basic concepts for the management and control of supply items are the same as those for commercial materiel management systems. Both seek to achieve the most cost-effective use of available resources.

15.8 A materiel management pipeline, whether military or commercial, will have as many junctions where buffer stocks are held, or where goods are unloaded, repackaged and shipped onward, as the length of the pipeline, the geography and the size and complexity of the flow dictate.

15.9 The demand for the goods flowing through a supply pipeline is seldom consistent or completely predictable. Since being out of stock can prove costly to operations, **system safety stocks** are required to provide a buffer in the event of an unexpected surge in demand or unexpectedly long turnaround times for repairs. These system safety stocks are required both for military and commercial systems.

15.10 In addition to system safety stocks, military supply pipelines, unlike commercial systems, also require stocks of critical items to be used during the enormous surge that occurs when military units consume ammunition, fuel and other supplies at full wartime rates. It can take months and even years for the national industrial base to convert to a full wartime capability for certain kinds of supplies. These buffer stocks of materiel for use by the military while industry is converting to full wartime production are called **"warstocks"**.

15.11 Even though it may not be possible to purchase all of the necessary warstocks prior to a period of escalating tension, it is important for the Department to determine what will be required and how it will be produced, stored and managed. These factors will have a significant bearing on the design of the materiel support system, the automated data processing requirements and the war establishments (personnel and equipment) of the support units required to manage and control the stocks. The work is also necessary to determine how these stocks will be reported and managed by operational commanders during combat operations.

15.12 We reported in 1987 that much work remained to be done by DND to determine suitable levels of warstocks, based on a sound evaluation of the capacity of the industrial base and the anticipated consumption rates of the fighting forces. To date, DND has not completed the process of identifying which items of supply should be warstocked, and calculations have not been made for materiel entitlements throughout all of the segments of the complete pipeline. Materiel entitlements have been developed for non-consumable items, primarily for first-line troops, and work is now under way to determine requirements at the other levels of support.

15.13 Appropriate scales have not been developed for all items that need to be warstocked. The DND policy on holding spare parts combines system safety stock requirements with warstock requirements. Since these two have not been separated and clearly identified, it is difficult to determine the correct amount to be held for each purpose. This precludes tight control of system safety stocks, which should always be held to the minimum level identified as necessary to avoid running out of critical items. Warstocks, by contrast, should always be held to the maximum level authorized and funded.

The White Paper on Defence Policy

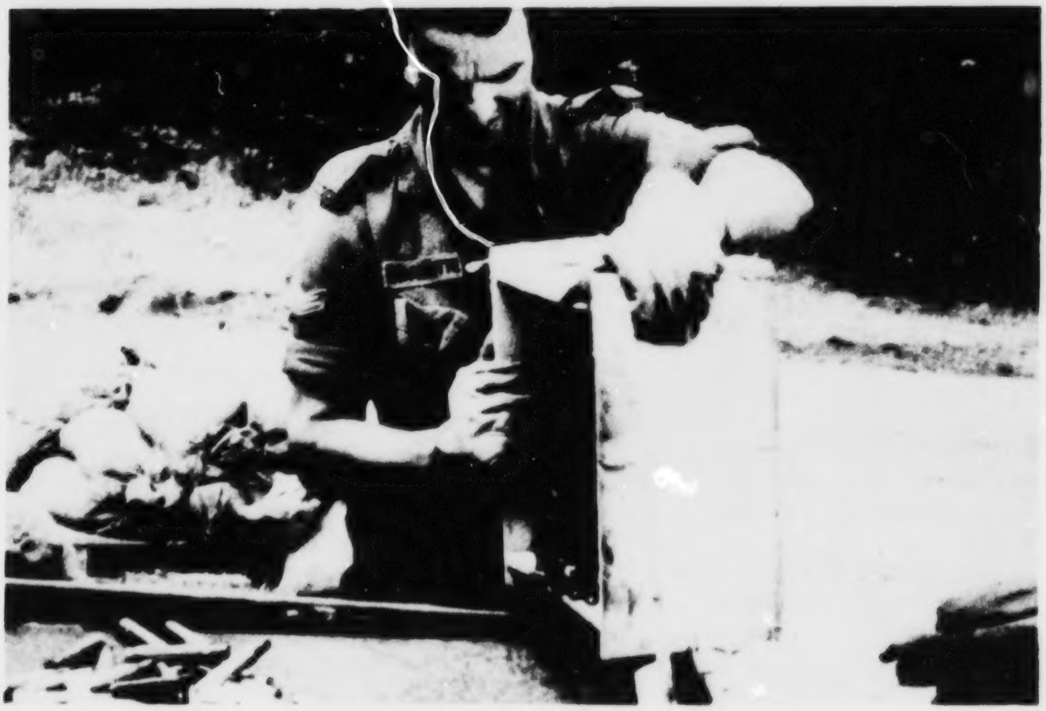
15.14 In 1987, the Government issued its White Paper on defence policy which noted, among other things, the need to devote more attention to logistics. The Department is working to define force structure requirements, support arrangements and funding requirements, to satisfy the objectives set out in the White Paper. Initiatives include the definition of combat support doctrine and concepts, a review of industrial preparedness, and mobilization planning. These are major, long-term initiatives. Considerable work remains to be done before the Department will have an integrated wartime logistics system.

Combat Supplies

15.15 The term "combat supplies" is a military term describing four important items – ammunition, rations, fuel and water – needed for combat. Although these four are considered critical to successful operations, they are not the only necessary items. Key repair parts and other items, such as communications equipment, engineering stores, medical supplies and an effective servicing, repair and return to battle capability for major weapon systems, can also be critical to the successful outcome of battle. In our audit we have added medical supplies to the four items in the military definition of combat supplies.

Audit Scope and Approach

15.16 We concentrated our detailed audit examination activities on ammunition and medical supplies. We examined the procurement practices, inventory management, distribution operations and policy structure for these items under conditions of both peace and war. We then linked these detailed reviews to our overall assessments of the major planning and feedback processes in the Department.



Ammunition technician sorts expended ammunition (see paragraph 15.17).

Ammunition

15.17 The current value of the DND inventory of ammunition for use in peacetime training and as warstocks is approximately $2 billion. DND spends about $230 million each year to replenish the ammunition used in peacetime training. In addition to this annual recurring cost, capital projects involving new weapon systems include funding for ammunition, both for warstocks and for two years' requirements for peacetime training. For large new weapon systems such as the CF-18 fighter aircraft, the cost of this initial procurement of ammunition can be high. In 1987, for example, we reported that the cost of missiles for the CF-18 could be as much as $3.7 billion.

15.18 During the 1960s and 1970s, the thirteen ammunition depots of the army, navy and airforce were consolidated into four Canadian Forces Ammunition Depots (CFADs). At present, these depots are approaching capacity and the ability of many of the buildings to utilize modern materiel handling technology is limited. Proposals are being processed to improve existing facilities and provide additional storage space.

15.19 **The Munitions Supply Program.** The Canadian Armed Forces are relatively small, and consequently the demand for ammunition for training in peacetime is also relatively small. Nations generally tend to be reluctant to rely on foreign sources of supply for ammunition which, in time of war, may be diverted for use by the producer nation's own military or may be unavailable because of their foreign policy decisions at that time. These factors have considerable impact on the scale of Canada's ammunitions industry and on the potential for exports.

15.20 Prior to 1978, a considerable portion of Canadian munitions requirements were purchased outside Canada because DND and the Department of Supply and Services (DSS) were pursuing a policy of procurement at lowest initial cost. During this period the Canadian munitions industry was in serious economic difficulty due to the changing nature and quantity of goods required by DND from year to year; the lack of offshore sales opportunities; the lack of spending by either industry or government on machinery and plant upgrading; and a shortage of trained production workers.

15.21 The Government approved a Munitions Supply Program in 1978, to establish and maintain a Canadian industrial capability for the production of high volume usage ammunition and associated stores, under a "preferred buy in Canada" policy. This was to be subject to a level of price performance that would provide an acceptable balance between the higher cost of procurement in Canada and the objectives of security of supply and industrial benefit. Among other things, it also anticipated the achievement of an effective supply program with respect to domestic and export sales, which, along with modernization, would make for a sound and economically viable industrial base.

> The production capacity required for war for all critical ammunition items has not yet been identified. Consequently, DND and DSS do not have systems and procedures in place to monitor the extent to which the strategic objective of the Munitions Supply Program is being achieved, or to measure the degree of economy and efficiency that has been attained.

15.22 Limited government funding was authorized to upgrade ammunition facilities and modernize plants, and Canadian suppliers were designated as preferred sources of supply for specific products, for a specified period of time. The intent was to encourage a high level of private ownership in a competitive Canadian munitions industry.

15.23 Currently, approximately 75 percent of the value of DND's annual procurement contracts for ammunition is let to Canadian companies; however, these companies purchase some ammunition components abroad. Five Canadian companies have been designated as preferred sources for ammunition procurement. Government funding mechanisms have been used for partial upgrading of facilities and machinery, and the preferred sources receive contracts on a negotiated cost-plus-profit basis. Despite this, many of the facilities in Canadian munitions plants are of World War II vintage and, on average, Canadian-produced ammunition costs DND more than the ammunition available elsewhere.

15.24 **Meeting wartime requirements.** The primary aim of the Munitions Supply Program is to promote the development in Canada of a munitions industry or of assured sources of supply, capable of meeting foreseeable wartime requirements of items considered by DND to be critical in war. The Program is being implemented by designating selected Canadian suppliers as preferred sources of supply for specific products.

15.25 In the early 1980s, DND and DSS considered the implementation strategy for the Munitions Supply Program to be highly successful. In their estimation, the Canadian munitions industry had been strengthened and made viable, Canada's self-sufficiency in high volume usage ammunition was almost in place, cost savings to National Defence had been achieved and exports had increased substantially. Since that time there has not been another formal evaluation of progress.

15.26 Reports and information reviewed during the course of our audit indicated that, although progress has been made in producing more ammunition in Canada and in achieving increased self-sufficiency in some high volume usage items, self-sufficiency has not been achieved for most of the other items considered by DND to be critical in war. There is still reliance on sub-components produced by foreign suppliers, and the major Canadian producer of ammunition is primarily a "load, assemble and pack" facility. Moreover, little is being done to stockpile critical components or raw materials not available in Canada.

15.27 A list of items considered critical for war was not prepared for the Munitions Supply Program. A list was prepared, however, for the Defence Industrial Preparedness Task Force. We noted that at least 90 percent Canadian content has been achieved on about 25 percent of the items on this list. These items account for approximately half of the value of annual ammunition purchases. Another 11 percent of the items on this critical item list have at least 60 percent Canadian content. However, a further 25 percent of the items have less than 10 percent Canadian content. Canadian content on the remaining 39 percent had not been identified.

15.28 With respect to cost savings, the preliminary results of a price study under way in DSS, comparing ammunition produced in Canada with similar ammunition items purchased by NATO allies, indicates that Canadian-produced ammunition costs 30 percent more than the lowest prices available from other NATO suppliers (about $50 million annually). However, this comparison does not tell the whole story. Other nations outside of both NATO and the Warsaw Pact produce ammunition. Some of these have production advantages such as efficient plant and equipment capability, economies due to large scale production or a cheap labour force. Although no price comparison studies have been completed recently, DND and industry officials indicated that the prices available from these other sources could be considerably lower than the prices in the DSS study.

15.29 Wartime demand for military supplies is difficult to predict. The requirement for ammunition can change dramatically, depending on the particular scenario envisioned. Nevertheless, reasonable estimates of demand, based on agreements with NATO allies, are available. It may be desirable to have an independent Canadian capability for ammunition production, even if the full wartime demand cannot be met during the initial stages of any potential conflict. Although initiatives have now begun, DND has not yet defined the production levels needed to satisfy wartime requirements. This is the essential first step in determining the amount and type of excess capacity for war that the industry must acquire, and that must be subsidized in peacetime to meet the strategic objective of the Munitions Supply Program.

15.30 With this first step completed, DND could then calculate the requirements for warstocks to bridge the gap until industry could expand its scale of operations to the desired wartime levels. As an interim measure, it might be necessary to warstock critical components currently purchased from foreign sources. After completing this work, DND and DSS could review the existing pattern of direct and indirect funding mechanisms. For example, it may prove more efficient to fund underutilized plant capacity directly to meet wartime production levels, rather than paying a premium for peacetime production. The funding framework could be structured to provide incentives for increased efficiency and vertical integration (for example, the acquisition of companies producing sub-components, where this is economically justified) to make the industry self-sufficient.

15.31 In October 1987, DND formally initiated a study with the United States to determine the viability of a North American defence industrial base for the production of ammunition, for both peacetime and wartime consumption. To complete this study, it will be necessary to compute the DND ammunition production requirements for wartime. When complete, these computations may provide the first step in determining the level of surplus capacity required.

15.32 In any event, ten years after the initiation of the Program, although a high degree of self-sufficiency has been attained for some high volume usage items, self-sufficiency for most items is still quite low. Production capacity required for war for all critical ammunition items, including those with high Canadian content, has not yet been identified. Export sales are still relatively small and prices are significantly higher than those charged by foreign sources.

15.33 **Procurement and stock levels.** The system used to manage the replacement of ammunition consumed each year for training should be designed to minimize the cost of stock holdings, consistent with an accepted level of risk of "stockout". This is the standard materiel management computation used in both the private and public sectors. Holdings of warstocks, however, should be to the maximum level authorized, consistent with other DND priorities and the availability of funds. For a number of reasons, DND has procured more ammunition than is required to replace what is used in annual training. It is now holding levels of ammunition that, when warstocks are included, exceed the total levels authorized by about 11 percent; however, the levels of training ammunition exceed the authorized levels by about 33 percent, enough for about one year of usage.

> DND is carrying over $205 million in training ammunition stock above the levels authorized or needed to support normal usage. This represents an expenditure that might have been employed productively elsewhere. There is an annual carrying cost of this excess stock, which will continue for as long as the situation remains uncorrected.

15.34 There are two primary reasons why this additional stock has accumulated: support of the Canadian ammunition industry at a level of production higher than that required by DND in peacetime; and DND procurement practices over many years.

15.35 One of the goals of the 1978 Munitions Supply Program was a Canadian ammunition industry that would grow and prosper and would eventually become economically viable. Nevertheless, DND has been asked to procure ammunition to levels exceeding its requirements, in order to assist the industry. We estimate that there is at least $110 million worth of additional stocks of ammunition currently in DND depots, as a result of arrangements between DND, DSS and the industry, to provide the industry with an agreed volume of business. Furthermore, there is a cost penalty to holding more stock than necessary, which continues for as long as the situation is not corrected. The magnitude of these cost penalties is discussed later in this chapter.

15.36 A further $95 million worth of additional stock is the result of DND procurement practices over many years. The automated Canadian Forces Supply System, which handles about 1.5 million line items, was designed to compute economic order quantities and minimize the cost of stock holdings. Ammunition, however, is not managed using the Canadian Forces Supply System automated function.

15.37 Although management of the ammunition inventory has improved over the past two years, procurement decisions are still handled using a stand-alone automated reporting system, which does not formally compute economic order quantities. Rather than computing the minimum stock level and reorder level for each different ammunition type, DND ammunition policy authorizes stock holdings of not less than six months' and not more than two years' supply of domestically produced ammunition, for training purposes. We found that, in addition to procurements to support industry, DND had, in fact, procured stocks to levels in excess of the two-year maximum allowed by the policy. In 1986, the Department recognized that this practice was resulting in large amounts of inventory that exceeded peacetime requirements. Steps were taken to cut back on ammunition procurement and, in some cases, reductions have already taken place. However, success in this area will depend on the outcome of the review of the Munitions Supply Program initiated in May 1988.

15.38 The implementation strategy for the Munitions Supply Program should be reviewed and amended by DND in conjunction with DSS, to ensure that the objectives of the program will be implemented at the lowest possible cost.

15.39 DND and DSS should review the practice of assisting the ammunition industry through price premiums and the purchase of more ammunition than is needed to support DND's requirements.

15.40 DND should reduce excess ammunition stocks and should attempt to refine its guidelines for holding training ammunition, to incorporate automated techniques for economic order quantity considerations.

> ***Department's response:*** *The Department concurs with the recommendations. Direction has already been given to review the Munitions Supply Program, its implementation and the various industry support mechanisms.*
>
> *The Department aims to reduce ammunition holdings over time and to review the incorporation of automated techniques for economic order quantity considerations.*

Medical Supplies

> DND needs to develop a medical supply system that will provide the framework for a complete wartime capability and that will also be capable of providing efficient and economical support in peacetime. This overall capability could be achieved by converting the existing system to a wartime framework within which would be embedded an efficient peacetime capability.

15.41 Good medical support is critical to morale and successful military operations. An effective program of preventive medicine and quality treatment is important in peacetime. During conflict, prompt and effective treatment of casualties, including evacuation where necessary, is essential.

15.42 In combat, the medical support system consists of a flow of medical supplies forward to field treatment facilities and a return flow of wounded to the appropriate hospitals in the rear. Because of its importance, DND has chosen to operate it as an entirely separate system.

15.43 The medical supply system is an important component of the medical support system. Often the same vehicles used to transport casualties to the rear are used to transport medical supplies forward, and both the medical care and medical supply sub-systems are driven by the pace and severity of the battle.

15.44 Until recently, it was DND policy to use the medical support systems (including medical supplies) of our NATO allies for a major portion of the logistics pipeline behind our troops currently assigned to NATO in Europe. This policy has now been amended to ensure that medical support from the front lines in Europe all the way back to Canada will be Canadian throughout. Plans are under way to provide this capability; however, they do not address the wartime support of the remainder of the Canadian Forces.

15.45 The medical supply system in DND is at a turning point. The existing system of six static medical equipment depots is primarily a peacetime system catering to peacetime medical needs. Five of the six depots serve the geographical regions in Canada. With the exception of providing a fourth-line medical depot in Canada, this static network is not capable of supporting forces deployed outside Canada. Even forces deployed within Canada or operating from Canada would probably require closer support than these fixed facilities could provide.

15.46 In peacetime, the costs of DND medical supplies amount to about $12 million a year. This represents only a tiny fraction of the total medical supplies consumed each year by Canadians. Civilian requirements are filled by a large commercial medical supplies industry, which supplies civilian hospitals, clinics and pharmacies across Canada from its own transportation, distribution and warehousing network. For many line items, the cost of this network is included as a fixed cost within the market price. DND purchases its supplies from the same industry and, although it provides its own distribution network, on average it is paying

Forward surgical hospital (see paragraph 15.42).

only marginally lower prices than those paid by other customers. The majority of DND's medical supplies purchases are delivered to a central depot where they are stored and subsequently transhipped to a regional depot, where they are stored again and then shipped to the user units as required. Large stocks, with a total estimated value of $12 million, are carried at the central and regional depots.

15.47 A major part of our work involved assessing the feasibility of making increased use of direct supplier-to-user deliveries through the commercial medical supply infrastructure. We concluded that a significant increase in the use of direct supplier-to-user deliveries would be both appropriate and feasible.

15.48 In addition to a substantial reduction in the $12 million inventory held at the depots, we estimated that significant savings could be achieved in the total cost of DND's warehousing, distribution and transportation system for medical supplies, if the existing system were converted to a wartime framework within which would be embedded an efficient and economical peacetime system. If the current peacetime system were simply modified in the light of our findings, it would result eventually in a system for peace and a separate system for war with all of the redundant costs and potential confusion during the unfolding of the alert system.

15.49 The Department should develop a plan for a wartime medical supply system that could be operated efficiently and economically in either peace or war, and that would feature direct supplier-to-user deliveries whenever feasible. The Department should then acquire the key elements needed to train for war, to provide a suitable base for expansion and to provide the desired level of peacetime service. This could be achieved through the conversion of the existing peacetime medical supply system.

> ***Department's response:*** *Agree. The Department has plans already under way to implement the major recommendations contained in this report.*

Maintenance

Background

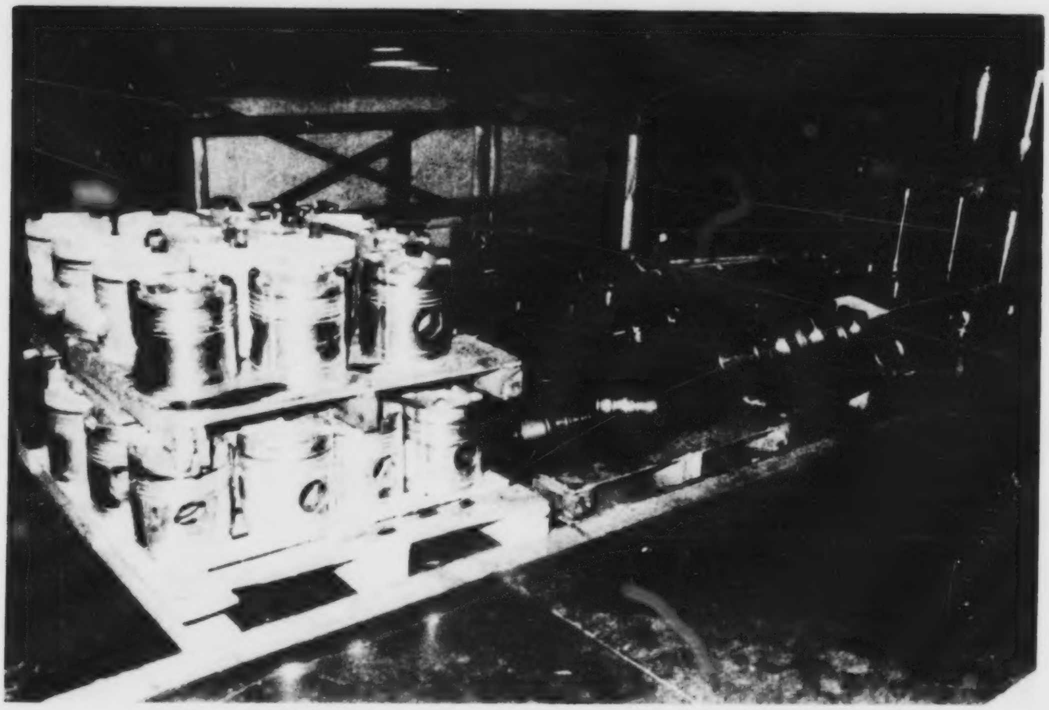
15.50 As a result of our 1987 audit, which included a review of supply support to maintenance, we concluded that the Department was experiencing difficulty in managing its repairables pipeline. This was largely due to deficiencies in management information systems and a need for improved training of those responsible for managing the pipeline. The Department is now engaged in a "Repair and Overhaul Enhancement Program" designed to improve the management information used to control repairable items. A training program has been introduced to enhance the skills of Supply Managers.

15.51 Most repairable items are spare parts for weapons systems. Of the 1.5 million items managed by the Canadian Forces Supply System, about 33,000 are repaired under contract to the private sector or in third-line DND repair facilities. The value of these items accounts for about half of DND's $7.5 billion inventory.

15.52 The management of repairable items is much more complex than for consumable items. After a weapon system is introduced, there are, in effect, three parallel but related processes taking place at the same time.

15.53 **Initial provisioning and reprovisioning.** Stock levels are first determined during the initial provisioning process as part of the acquisition of the weapon system. The Department uses complex models to determine the amount of spares needed to achieve a satisfactory level of availability for the entire weapon system throughout its service life. In most cases, there is little real-life data on such a weapon system, which is often at the leading edge of technology. After it is introduced, stock levels are adjusted up or down throughout its life, based on experience with it.

15.54 Reprovisioning involves acquisition to replace parts that can no longer be repaired, or to increase holdings. Because of their longer life, repair parts tend to be purchased less frequently and in smaller quantities than consumable items. Purchasing has often required manual intervention in the computerized methods of the Canadian Forces Supply System. Supply managers switch to manual methods because of problems with the

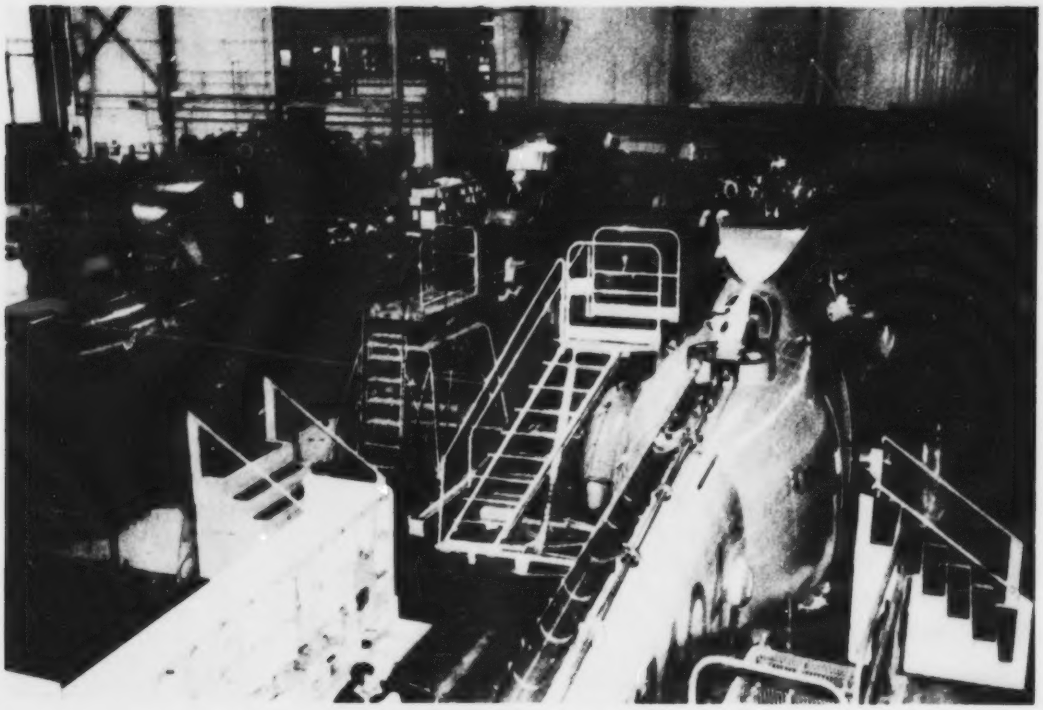


Repair parts (see paragraph 15.51).

reliability of data in the CFSS, or for special requirements that cannot be planned for using historical data, such as major refits, equipment phase-outs, planned modifications or lifetime buys.

15.55 **The repairables pipeline**. The second process is the management of these repairable items through the repair pipelines. Repairable items tend to move in a continuous loop. When a repairable part fails to function on a weapon system, it is removed, tested and packaged for shipment. It later ends up in a repair facility (either the Department's or a contractor's), where it is inspected, repaired and tested. It is then returned to the Department and ultimately installed on another weapon system. Intermediate points in the loop may include Canadian Force bases, depots or testing establishments. Components used in the repair activity may be supplied by the contractor or by the Department.

15.56 The failure rate of components depends on usage rates, environment, age, design and product quality. Engineering and maintenance planning for peacetime cannot begin until decisions have been made concerning the concept of operation of the weapon system, desired availability levels, and the reliability that should be designed into critical and non-critical components. These decisions are made during the acquisition process, but can change several times over the life of the equipment, due to changes in mission, life extensions that may involve updated equipment, changes in the availability of funds, or a number of other



Sea King helicopters undergoing maintenance (see paragraph 15.55).

factors such as collective agreements or environmental requirements. Changes to concepts of operation throughout the life of the weapon system also create the need for adjustments to the support process.

15.57 **Warstock requirements**. In addition to stocks held to meet pipeline requirements and safety stock held in the reprovisioning process, there may be a need to hold warstocks of some components. Planning for wartime repair and overhaul is technically complex. During wartime, equipment usage rates would jump dramatically, and the operating environment would become severe. As a result, component failure rates and repair requirements would increase dramatically. At the same time, entire weapon systems could be lost at a high rate, which would quickly reduce the requirements for repair and overhaul, unless replacement weapons could be built or bought. Clearly, planning for repair and overhaul in these circumstances requires a carefully designed concept of force structure requirements, anticipated usage and losses, and the likelihood of building or buying new weapon systems, and then delivering them to the battle zone. While it may not be possible or practical to hold all warstock requirements in peacetime, it is essential that the necessary plans and calculations be completed.

Scope of Our Review

15.58 We reviewed a number of the principal systems and controls used to manage items designated by DND as being repairable at third-line facilities. These include systems and processes related to determining requirements, contractor and departmental turnaround times, warranty provisions, cost trends, financial controls and compliance, and post-repair contract audit. We examined these systems and controls against both peacetime and wartime requirements. We also tested the appropriateness of current inventory levels of repairable parts.

Determining Requirements

> As we reported in 1987, there is a general requirement to clarify doctrine and concepts of operation for Materiel Support. Steps are now being taken to develop force structure arrangements against current tasks, and to define the processes that would apply for supply, maintenance and distribution operations. As part of this work, there is a need to determine stockpile requirements for critical items, including repairables.

15.59 To date, no steps have been taken specifically to address contract repair and overhaul requirements for wartime, although this area has been identified by the Industrial Preparedness Task Force as requiring attention. Before this can begin, force structuring arrangements will have to be finalized so that equipment establishments and support arrangements are known. As well, it will be necessary to determine the capability of Canada's industrial sector to provide replacement weapon systems and components as well as the stockpile requirements for spare parts, considering such factors as expected usage rates, demand patterns that reflect attrition and replacement rates, and the capability of Canadian and foreign firms to meet requirements. Steps have been taken to overcome the barrier of the distance between repair contractors in Canada and the probable locations of battle, through the signing of a Joint Logistics Plan with the United States. Decisions are now needed about which items should be transported under this arrangement and which should be pre-positioned. Given the critical role that repairable items will play in keeping weapon systems available for combat, it is important that this aspect of the materiel support framework be designed against wartime requirements.

Inventory Management

> The management of repairable items in DND is a complex task that is made more difficult by the need to update support systems and controls. At this time, about 16 percent of the Department's inventory of repairable parts exceeds peacetime requirements; shortages of other parts also exist. These were caused by initial provisioning decisions made several years ago and by aspects of the Department's purchasing practices that need review. A somewhat smaller amount of long and short supply has resulted from situations largely beyond DND's control. As well, there is about $800 million in repair parts and major end items held outside of the repairables pipeline in first-line accounts, some of which is against entitlements that need to be reviewed. The Department has initiatives underway to address most of these concerns.

15.60 The Department's inventory of repairable parts has been valued at $3.4 billion: $2.4 billion in smaller components (B-Class), and another $1.0 billion in larger (A-Class) items, such as aircraft engines. Of the $3.4 billion, about $800 million is kept in first-line accounts, for operational purposes. At the time of our audit, 12,000 of the 33,000 items we were testing had "closed" pipelines – a situation that occurs when the amount of stock in the pipeline exceeds 36 months of peacetime usage.

15.61 We tested inventory levels of the $1.6 billion of B-Class items that are held in locations other than first line, and of the $1.0 billion of A-Class items against repair pipeline requirements. We also reviewed the $800 million held at first line against the authorized levels specified in the Canadian Forces Supply System. We reviewed these first-line holdings against the Department's stockpile guidelines used to determine warstock requirements. Any variances from these required levels were discussed with DND staff to determine why they had occurred, and estimates were made of the dollar impact of these different causes.

15.62 **A-Class Items.** Because of their higher value, these items, which include things like aircraft engines and other major assemblies, are given a great deal of management attention. We tested a sample of aircraft engines, which account for about $700 million of the $1 billion of inventory in this category. We found that when current holdings are compared to pipeline requirements, there is no indication of significant excess or shortage.

15.63 **B-Class Items.** Our analysis indicated that about 16 percent of the inventory in the repairables pipeline, worth about $250 million, exceeds current requirements, as a result of systems and practices that should be reviewed. We also observed that there are shortages of other parts, which have the effect of reducing operational readiness. It would have cost the Department about $50 million at the time the parts were purchased to avoid these shortages.

15.64 A minor cause of long supply relates to long turnaround times needed to carry out repairs. Officials of the Department have indicated that a portion of the supply exceeding current requirements results from a time when repair contractors were unable to meet required repair turnaround times. In order to meet operational objectives, the Department bought additional stock. Since repair parts have a long life, much of this additional inventory is still in the system. At the same time, shortages worth about $20 million now exist due to long turnaround times that have not yet been corrected.

15.65 About $100 million (40 percent) of the long supply and $10 million (20 percent) of the short supply result from initial provisioning decisions for fleets that have been in service for a number of years. As previously explained, in these cases the amount of inventory purchased was based on available data on such factors as planned usage rates and environment, component life and the anticipated future availability of replacement components. Differences between the original assumptions and actual circumstances, which in many cases were unavoidable, have resulted in the variances we observed. Although improvements to the data used in the initial provisioning process could reduce these differences in future, the benefits would have to be compared to the cost of effecting the improvements.

15.66 About $100 million of the excess over current requirements resulted from a number of other factors and practices that we have suggested should be reviewed. The Canadian Forces Supply System, which was designed in the late 60s and implemented in the early 70s, has several shortcomings when used to manage repairable items, many of which were described in our 1987 Report. Chief among these are the need for improved training of supply managers and the fact that the system was designed largely to meet the peacetime reprovisioning needs of consumable items. The Department has initiatives under way to respond to both these needs.

15.67 In addition to the excesses and shortages discussed in the paragraphs above, there is about $200 million of inventory that exceeds current requirements, but that resulted from a number of factors that were either beyond the ability of the Department to influence or predict, or were a normal aspect of the management of repairable items. These include an unexpectedly long time needed to set up a repair process; declining usage of some fleets, which led to a lower demand for parts; decisions to retain older components as the only remaining source of parts; and lifetime buys of some components to ensure the availability of parts.

15.68 Another small portion of the apparent long supply and short supply ($50 million and $5 million, respectively) relates to items bought for the initial provisioning for the CF-18 aircraft. Because this aircraft is not yet operating at full rates, current pipeline holdings will, in most cases, exceed current requirements. According to DND officials, when the aircraft is in full service these apparent surpluses and shortages should disappear.

15.69 **Turnaround times**. The number of items needed to keep a pipeline full increases in relation to the total time taken to carry out a repair, including DND processing time and contractor turnaround time. We found that the 90-day turnaround time usually specified in repair contracts was seldom achieved. Contractor turnaround times ranged from 40 to 327 days, and departmental processing time ranged from 10 to 120 days. DND has recognized the need to improve controls over turnaround times where it is practical and cost-effective to do so, and is now taking steps in this area.

15.70 **Holdings at first line**. We reviewed inventory holdings at first line against the levels authorized. We found that holdings at first line are generally consistent with the levels authorized.

15.71 The $800 million of parts and repairable inventory at first line is held for two purposes. Materiel in use, accounting for about $550 million of first-line holdings, consists of major end items such as generators that are kept to meet operational needs; the remaining $250 million consists of repair parts held as warstocks. The materiel in use is held against formal authorizations that specify both peacetime and wartime entitlements. In most cases, holdings are limited to the peacetime entitlements, due to funding limitations. There is a need to update and expand both the peacetime and the wartime authorizations to cover the full range of defence commitments. Authorizations for warstocks of repair parts vary, depending on the environment. For navy operations, formal authorizations have been established that are reviewed and monitored at National Defence Headquarters. For army and airforce operations, authorizations are set and approved at the local operational level.

15.72 As we have already noted, there is a need to clarify and update stockpile requirements for the repair pipeline and for warstock purposes. Also, the Department needs to examine the costs and potential benefits of additional approaches for improving the management of repairables. These could include penalties for late delivery and incentives for surpassing delivery targets; minimizing internal processing time; and improving the reliability of the data used in the initial provisioning processes.

15.73 The Department should further define inventory requirements for repairable items throughout the materiel support system from first line to fourth line. Current holdings should be reviewed against these requirements. Excesses should be disposed of unless their retention can be justified on the basis of future requirements. The costs and benefits of ways of optimizing inventory holdings should be investigated.

> ***Department's response:*** *The complexity of repairable item management, as indicated by the Auditor General, has long been recognized by the Department. As also noted in this report, the Department, over the years, had initiated several measures to improve the process.*
>
> *The Department agrees with this recommendation and has already embarked on further measures to enhance the process, where cost effective to do so.*

Warranties

15.74 Only A-Class items are individually tracked by the existing CFSS. Prior to leaving a repair contractor, a B-Class item undergoes a number of inspections and tests. Each item is marked by the contractor to indicate the date of the last repair or overhaul. Due to the volume of parts in DND's pipeline and the greatly varying demand, a part may not be installed on a piece of equipment for some time. This can occur later than the period covered by the warranty, which in most cases is for one year, thereby nullifying the protection. A warranty based on performance would overcome this difficulty, but would require additional administrative procedures.

15.75 Procedures are not in place to monitor and provide reports to National Defence Headquarters (NDHQ) on the warranty process. When field maintenance officials become aware of an unusually high rate of failure, they raise an Unsatisfactory Condition Report, which is forwarded to supply and maintenance staff at NDHQ. This process would be improved if information were available indicating when a component had been installed, to serve as a basis for determining whether the item had performed for a reasonable length of time. We discussed maintenance practices with officials of a number of private sector operations, who indicated that tracking of high value items is essential in monitoring contractor performance and obtaining warranty protection.

15.76 Information on items that have been earmarked for possible warranty work is held by DND personnel at contractors' plants. It is not, however, routinely provided to procurement or maintenance officers at NDHQ. Also, consolidated information on warranty activity or costs is not readily available.

15.77 The Department does not have a policy on warranty management, and there is no departmental procedure on warranty administration. Several years ago the Department suggested to the Department of Supply and Services that a standard approach to warranties be developed. To date, little action has resulted from these efforts. Estimates of the costs of warranties range from one percent to three percent of contract value, which for contract repair and overhaul translates into between $5 million and $15 million annually. There may be an opportunity to achieve greater benefits from this expense.

15.78 The Department should assess the costs and benefits of warranty alternatives, including those based on performance.

> ***Department's response:*** *Agreed. The Department has recognized for some time the need for such an assessment and preliminary studies have been conducted. These will be further defined and appropriate guidelines developed if required.*

Contract Review and Audit

15.79 Over 75 percent of repair and overhaul contracts are sole-sourced (that is, let without competition) or single-sourced (no competition exists) to Canadian firms. In many cases this is unavoidable, due to the lack of competition resulting from the small size of Canadian industry, the high cost of setting up the specialized kinds of repair and overhaul processes required by DND equipment, and other factors such as technical data rights or licensing agreements. A senior-level Review Board was established several years ago and one of its responsibilities is to ensure that every effort is made to maximize competition.

15.80 In the absence of competitive pressures, sole- and single-sourcing entail the risk of higher prices or reduced attention to quality. In this environment, we expected to find increased emphasis on controls and information processes that would compensate for the lack of competition. These compensating controls have not been established, and there may also be a need for other controls.

15.81 For example, although repair costs are monitored at contractors' plants, this information is not used to compare increases in repair and overhaul costs to cost increases in similar private sector operations, or in the economy in general.

15.82 In addition, contract review and audit coverage is limited. Chapter 16 of this Report discusses the contract enforcement practices of the Department of Supply and Services, highlighting the need for expanded and improved audit coverage of contracts, including repair and overhaul contracts managed by DND.

15.83 DND and DSS have been reviewing methods to increase competition. An initial review of six sole-sourced contracts resulted in the conclusion that it would be feasible to increase the level of competition.

Management Information Systems and Feedback Mechanisms

15.84 The major source of information about repairables is the Canadian Forces Supply System (CFSS). The CFSS is now undergoing a major upgrade that should be completed by 1995, at a cost of about $250 million.

15.85 The management of the repairables pipeline requires a high degree of technical input based on equipment usage, maintenance performance and estimates of component failure rates. Weapon systems regularly undergo major overhauls, mid-life upgrades or refits, all of which require the repair and overhaul of components. The normal reprovisioning processes of the CFSS, which are based on historical usage, generally require manual adjustment.

15.86 The concerns noted in previous sections – the inability to monitor component performance or invoke warranties, the need for assessments of contractor performance and turnaround time, stock levels that exceed current requirements, and the lack of contract audit – all point toward the advantages of tracking and accounting for individual repairable items wherever cost-effective. One way of achieving this would be by adopting Weapon System Management (WSM) techniques.

15.87 Weapon System Management approaches are now being evaluated by the Department. There are many ways of approaching WSM, but they all involve managing components from the viewpoint of total system availability to meet operational requirements, minimizing the cost of a weapon system, and tracking component performance against targets. Adopting WSM techniques would have a significant impact on the methods used to manage repairable items. It is important, therefore, that the new supply system, which could be operational for 20 or more years, be designed to accommodate whatever maintenance management philosophy is ultimately adopted.

15.88 **The Department should ensure that the upgrade of the Canadian Forces Supply System can accommodate the possible future adoption of Weapon System Management concepts. The management systems involved in the repair and overhaul process, including those for quality assurance, contract audit, inventory management, warranty management and monitoring contractor performance, should be designed to achieve acceptable levels of total weapon system availability at a minimum cost.**

> ***Department's response:*** *The Department is currently in the midst of a significant project aimed at further defining and trialling the introduction of a Weapon System Management concept. The Project Manager of the CFSS Upgrade Project is a member of this project to ensure there is close liaison between the two projects and the CFSS Upgrade will be able to implement the WSM approaches decided upon. While in peacetime the aim is to achieve acceptable levels of weapon system availability at a minimum cost, it should be noted that in wartime the cost factor may well be of secondary importance. Any WSM approaches adopted by the Department must therefore be flexible enough to support either peacetime cost constraints, or adapt to the different information needs of a wartime scenario.*

15.89 The Department has taken steps to improve communication between the supply managers responsible for purchasing parts and the life cycle materiel managers responsible for managing weapon systems. A "Repair and Overhaul Enhancement Program" was also initiated as an add-on to the current CFSS, to improve control over repairables. If Weapon System Management techniques are adopted, however, there will be a need to review the responsibilities of supply managers and life-cycle materiel managers, in areas such as the initiation of reprovisioning actions, monitoring of contract performance, and initiation of repair actions. There will also be a need to achieve a high degree of integration between the CFSS and the various maintenance management information systems.

15.90 The review of the possible adoption of Weapon Systems Management techniques should include a review of the impact WSM will have on responsibilities for identifying, initiating and executing purchase and repair and overhaul actions. The upgrade of the CFSS should take into account the need for a high degree of integration with the various maintenance management information systems.

> ***Department's response:*** *Agreed. If the adoption of the impact of WSM techniques requires further elaboration of these responsibilities, they will be dealt with as part of the normal introduction of WSM. It should be noted however, that the Department does not expect any major organizational or structural changes to occur as the result of a WSM introduction.*
>
> *The CFSS Upgrade Project will endeavour to ensure that integration with various maintenance management systems will be possible when judged appropriate.*

Quality Assurance

Assuring the Quality of Military Goods

15.91 Linked to issues of product performance, warranty protection and contract auditing is the quality of the product delivered to the Department. DND is responsible for ensuring that military goods and services obtained from industry and provided to the Canadian Forces are suitable for their intended purpose. It is the responsibility of the Department of Supply and Services to provide quality assurance for non-military items.

15.92 A staff of 1,250 people, approximately 900 of whom are located in the 19 Canadian Forces Technical Services Detachments located across the country, deal with 3,000 contractors and monitor over 33,000 contracts per year. The current total value of contracts is $11.8 billion. It costs DND about $60 million annually to carry out quality assurance activities.

15.93 The DND Quality Assurance Program for military goods is based on the principle that contractors are responsible for the quality of their product and are required to provide documentary evidence that they have effective quality control systems. DND staff evaluate contractors' quality assurance systems to ensure that they meet the requirements of the contract. Representatives in the contractors' plants then verify, on an on-going basis, that these procedures are being implemented. The representatives may inspect a sample of the final product or review test results and contractor's inspection records related to the product.

Audit Scope

15.94 We reviewed DND quality assurance policy and procedures, tested whether they were being followed in a random sample of Canadian contracts, and investigated "quality problems" being experienced in a random sample of Canadian contractors. Our investigation involved a review of files, registers, correspondence and failure reports for a sample of contractors to identify the frequency of quality concerns. In addition, we interviewed DND staff regarding problems experienced with these contractors.

Policy and Procedures

> We found that DND has a comprehensive set of quality assurance procedures that are consistent with the requirements of the NATO Allied Quality Assurance Publications Standardization Agreement. We also found that the incidence of identified quality concerns is low.

15.95 In general, we found little in the way of significant or recurring problems with contractors. In cases where there were problems, they could not be clearly attributed to weaknesses in the contractor's quality assurance system.

15.96 There were few notable deviations in the application of the prescribed quality assurance procedures. The only significant exceptions were two ammunition contracts. We found that no evaluation of the two companies' quality assurance procedures had been carried out by DND representatives because the companies did not have any approved written procedures for quality assurance. Given DND's philosophy of quality assurance, the evaluation of a company's procedures is the basic foundation for ensuring that the quality requirements of a contract will be met. In 1987, we reported that 12 million rounds of defective ammunition had been accepted by DND, and that the problems could have been prevented if a standard quality test had been carried out.

Contractor Recognition

15.97 DND's Contractor Recognition Program is considered to be one of the most critical aspects of its future Quality Assurance Program. The objectives of the Program are:

- to identify contractors who have demonstrated their capability and commitment to comply with the required quality assurance standards; and
- to reduce the extent to which contractor assessments are performed at peak contract placement periods.

15.98 The Contractor Recognition Program involves the assessment of a company's management framework and quality control systems against NATO's highest quality assurance standard. DND adopted this standard in 1984. At that time, all contractors who had previously been awarded recognition under DND's own quality assurance standard were automatically granted recognition under the NATO standard. Early in 1986 DND began a process of re-assessing these contractors against the NATO standard. Once re-assessed, the contractors were given one year to respond to and implement any required corrective action.

15.99 This program of re-assessment is taking longer than anticipated to implement. In the past two years only 14 of the 80 previously recognized companies have been granted the new status. This initiative has fallen behind schedule because some contractors are experiencing difficulty in responding quickly to the new standard, and because of competing priorities within DND's Quality Assurance Division. Since meeting the new standard means that greater reliance can be placed on the contractor's quality control system, the re-assessment process is critical to reducing the number of DND representatives stationed full-time in contractors' plants.

15.100 The Department should complete the re-assessment of contractors against the recently adopted NATO quality assurance standard as quickly as possible.

> ***Department's response:*** *Agreed. The Department will continue its efforts to accelerate the recognition program.*

Management Information

15.101 The Department's Quality Assurance Management Information System (QAMIS) does not contain any information on the history of failure by contractors to meet delivery dates, the number and level of corrective actions required, the incidence of product defects or failures, or the value of work performed under warranty. Given DND's concept of quality assurance, it is important that such quality-related contractor performance information be available. Performance data would provide a basis for rating suppliers, would facilitate the identification of trends in particular problem areas, and is essential to evaluating the effectiveness of the Department's quality assurance activities. DND is proceeding with the development of an upgraded QAMIS and intends to include contractor performance information in this system.

15.102 The primary basis for the reallocation of resources of field representatives to contractor locations is the number of contracts, volume and complexity of equipment being produced, type of activity and experience of the contractor. Although DND officials have indicated that past contractor performance is considered in reallocating resources among contractors, QAMIS does not contain the performance information needed to formalize the process. We have noted that in the United Kingdom there is a move away from maintaining continuous staff in contractors' plants and toward the use of other approaches, such as acceptance testing of products and spot checks of contractors' quality assurance procedures. Until improvements are made in the underlying information systems, however, it will be difficult to establish a basis in Canada for similar decisions.

15.103 The Department should ensure that the future upgrade of the Quality Assurance Management Information System includes a comprehensive data base of contractor performance information. This information should be used to assess alternative approaches to ensuring the quality of goods received, including the

redistribution of staff to areas of highest risk or problems, and greater reliance on field testing of components and spot inspection of contractors' quality practices.

> ***Department's response:*** *Agreed. The future Quality Assurance Management Information System will include a comprehensive data base of contractor performance information.*

The Cost of Holding Inventory

15.104 In 1987, we noted that there appeared to be a large amount of excess stock in DND's inventory, and we suggested that improvements be made in reporting of excess stocks, inventory management procedures and disposal practices. The Department responded that it was well aware that, due to the significant cost of holding materiel in depots, a mechanism for periodic review was essential. This year, our review of inventory levels in the areas of medical supplies, ammunition and repair parts has resulted in the identification of additional instances of stock levels that exceed current requirements.

15.105 It is generally accepted in government and industry that inventory in excess of requirements inflicts a cost penalty. This penalty is reflected in the opportunity cost of the unnecessary investment, as well as in the costs associated with increased requirements for warehouse space, personnel support and with obsolescence of stock. The major difficulty, however, is specifying precisely what this cost is for a given commodity within a given organization. Estimates of annual inventory carrying costs for private sector organizations have ranged from 15 percent to 35 percent of the value of the inventory. In the United States Department of Defense, carrying cost factors used by the different services range from 14 percent to 23 percent. In our 1987 Report, we applied a factor of 20 percent.

15.106 The existing Canadian Forces Supply System uses indicators of carrying costs that range from 25 percent to 40 percent. These factors are used in the computations that determine the amount of each item to order. Recently, however, after a review of carrying costs, departmental officials suggested that the cost of carrying DND's inventory may be as low as 10 percent of historical inventory value.

15.107 A number of points are important when considering what these carrying costs mean to DND. First, rather than disposing of items that exceed current requirements, it might be better to keep them if they would ultimately be used, and if the cost of carrying them were less than the net cost of disposing and then re-buying. Second, a major element of carrying cost is the cost of money, which is realized as the lost opportunity to buy some other important asset. It should not be inferred, therefore, that by reducing its inventory the Department can reduce its annual budget by the amount of this opportunity cost. Third, different items may involve greatly differing handling and storage costs. An expensive but very small computerized component may require less space, but more attention, than a larger but less costly round of ammunition.

15.108 Small changes in carrying costs result in significant changes to the amount of inventory that the system will, on average, carry. The Canadian Forces Supply System is undergoing a major upgrade and now would be an appropriate time to review the carrying cost of DND's inventory, to ensure that, over the life of the new system, purchases are made at the optimum frequency and level.

15.109 Treasury Board and the Office of the Comptroller General have initiated a review of inventory management across government. As part of this review, they will be considering inventory levels and costs.

15.110 **The Department, in co-operation with the Office of the Comptroller General and the Administrative Policy Branch of Treasury Board, should determine cost-to-carry factors that can be applied to the various types of inventory it holds. The results of this analysis should be used for inventory management, and ultimately should be incorporated in the upgrade of the Supply System.**

> ***Department's response:*** *DND accepts, in general, the recommendation related to the cost of holding inventory. The Department will initiate a project in cooperation with the Office of the Comptroller general and the Administrative Policy Branch of Treasury Board to determine realistic cost-to-carry factors that can be applied to the various types of inventory held by DND. The project will take cognizance of the unique DND operating environment which, in some instances or situations, make it impossible or impractical to apply commercial or private sector "rule of thumb" standards.*

Reporting to Parliament

Background

15.111 Chapter 5 of this Report describes a government-wide review of Information for Parliament. The Department of National Defence was one of nine departments included in the review. Interviews were held with 24 Members of Parliament to obtain their views on existing mechanisms that provide them with information, and to seek their suggestions on possible improvements. Follow-up interviews were then carried out with Members of the Standing Committee on National Defence, to focus more specifically on defence matters. Also, we reviewed publicly available indicators of defence performance used in the United States and the United Kingdom.

The Purpose of Part III of the Estimates

15.112 Part IIIs of the Estimates are expected to provide, for every program, details of planned and actual results, related expenditures and other performance data to justify resource requirements, and sufficient background information to provide a basic understanding of each program. Treasury Board policy states that each Part III shall provide enough information to help Members of Parliament understand and assess a program's planned and actual performance in terms of results and related resources. Section II of the Part III must contain the information that provides the basis for determining the program's resource requirements for the Estimates year. Specifically, Section II is to contain:

- key indicators of performance for each activity;
- the performance of the activity with respect to such indicators; and
- a justification of the amount and type of resources required.

Observations on DND's Part III

15.113 Each of our 1982, 1984 and 1987 Reports contained references to DND's Part III. These references dealt with two major themes: linking defence resources to results; and reporting on Major Capital Projects. In addition, our 1987 Report discussed certain aspects of information for Parliament in connection with our government-wide review of Financial Management and Control Systems.

Linking Resources to Results

> DND's Part III does not provide sufficient information to assist Members of Parliament in understanding and assessing planned and actual performance in terms of results and related resources.

15.114 In 1982, we recommended that the Department determine, in consultation with Cabinet Committee, the appropriate planning elements for the Policy and Expenditure Management System, and a method of displaying costs in relation to these planning elements. In 1984, we made a number of recommendations that also concerned the reporting of defence results in relation to resources. These included the development of a force structure for both peace and war, linking tasks to costs, and co-ordinating the diverse reporting systems within DND to provide senior management with comprehensive reports on effectiveness.

15.115 In our 1987 chapter on DND's Materiel Support System, we reviewed internal feedback and reporting systems and the manner in which these internal mechanisms feed the flow of information to Parliament. We noted that a major constraint to reporting to Parliament was stated in the Preface to DND's Part III:

> "Due to the classified nature of the performance indicators used within the Department of National Defence to measure program effectiveness, the disclosure requirements for Performance Information and Resource Justification in Section II of the Program Expenditure Plan cannot be met."

Based on our examination, however, it appears that the provision of this kind of information is desirable, practical over the long term and possible from a national security standpoint.

15.116 Members of the Standing Committee on National Defence expressed a desire for information that would provide them with a better understanding of the defence program and that would allow them to assess the contribution that funding makes to meeting objectives. In areas where direct reporting of capabilities would compromise national security, alternatives such as expressing them as a percentage of a standard, providing a narrative assessment of the effectiveness shortfall, or providing *in camera* briefings to Members could assist in directing

Members to the sources of more detailed information. In addition, measures of peacetime performance in areas such as contracting, disposal of excess inventory, or operational efficiency in key areas would be useful to Members.

15.117 Many of the Department's major management systems are being upgraded, providing an opportunity for initiatives of this type. In the United States, efforts to produce and report capability indicators began over ten years ago, and effort has been directed since then to improving the information provided.

15.118 The Department of National Defence, in co-operation with the Office of the Comptroller General, should:

- **define indicators for reporting defence capabilities against requirements;**
- **define indicators of peacetime performance;**
- **establish a reporting approach for each of these indicators that will not compromise national security; and**
- **establish a timetable for introducing these indicators into DND's Part III.**

Current and planned efforts to upgrade or modify management information systems and processes should take into account these requirements.

> ***Department's response:*** *The Department will continue to work with the OCG to develop performance indicators, subject to the limits of national security. The Department will continue to supplement the information in Part III, as exemplified by update statements on defence policy. In addition, departmental officials are prepared to provide Parliamentary Committees with in camera briefings on classified matters.*

Reporting on Major Capital Projects

> DND has responded aggressively to earlier recommendations on clearly defining project scope and cost.

15.119 Our 1984 and 1987 Reports contained a number of observations that concerned the definition of the scope and cost of the major capital projects the Department manages. In 1985, the Public Accounts Committee also made a number of recommendations on this subject. These observations and recommendations dealt with the need to clarify the scope and cost of major projects; the identification, monitoring and reporting of life-cycle costs; the identification, monitoring and reporting of non-military objectives; and identifying and reporting the cost of non-military and strategic sourcing objectives associated with projects.

15.120 Work performed as follow-up to our 1984 and 1987 Reports indicates that DND's response in this area has been aggressive and properly directed. Standards and guidelines for life-cycle costing are now incorporated in internal procedures. Agreement has been reached with the Office of the Comptroller General on the elements that should be included within these costs, and such costs are now reported for approved projects in the Department's Part III. Similarly, non-military objectives are identified and reported in Part III's, and initial steps have been taken to establish the procedures for costing non-military objectives and strategic sourcing objectives.

Revenues

Background

15.121 The Department's revenues for 1986-87 amounted to $344 million. Of this, $300 million was credited to DND's budget. The revenues in this category included:

- recoveries for services and facilities provided to NATO and foreign governments, $100 million;
- rentals of married and singles quarters, $82 million;
- sales of meals, $30 million;
- sales of fuel to other departments, $21 million;
- medical, hospital and dental services to dependents, $16 million;
- educational services to dependents, $14 million; and
- other revenues, $37 million.

The remaining $44 million was credited to non-tax revenue in the Consolidated Revenue Fund.

15.122 Members of the Canadian Forces are required to pay for living accommodation and meals provided by the Department, unless they are in operational status. Charges for these services, which are not considered part of military compensation, are determined in accordance with Treasury Board regulations. They are recovered as deductions from pay.

Scope and Approach

15.123 After evaluating the risks, significance and other audit coverage for each type of revenue, we limited our detailed examination to rentals of married and single quarters and sales of meals. In addition, we reviewed the area of emergency assistance to the provinces, where collection problems had existed for a number of years.

15.124 We audited the assessment, collection and accounting for revenues for compliance with relevant statutory authorities. We did not attempt to assess the reasonableness of charges, nor did we examine supporting operations to determine whether they were managed with due regard to economy, efficiency or effectiveness.

Our review indicates that revenues from quarters and rations were generally assessed in accordance with the regulations and were properly collected and accounted for. The assessment and collection of fees for emergency assistance warrant additional attention.

Rentals of Married and Single Quarters

15.125 The Department provides living accommodation for married and single personnel. Rents for married quarters are based on market rental values for individual units as appraised by Central Mortgage and Housing Corporation. Adjustments are made for provincial rent control legislation, size suitability, income levels, phased increases and other factors. Rents for single quarters are based on a national average rent for a standard unit adjusted for local conditions.

15.126 The Department's adherence to rent control legislation complied with the Treasury Board Policy on living accommodation charges, but caused actual rents to be $8 million less than the appraised rents, in those provinces that have such legislation. A departmental study on accommodation for Canadian Forces families indicates that annual costs exceeded revenues in 1984-85 by approximately $16 million.

15.127 We examined the method by which rents are determined, and carried out tests to determine whether the rents collected were in line with the authorized rates. Our review indicated that, in all material aspects, rents were set in compliance with Treasury Board regulations and were properly collected and accounted for.

Sales of Meals

15.128 The Department provides meals for Forces personnel at messes on bases, ships and in the field. Members in operational status are entitled to meals at no cost. Members who live in single quarters are required to eat at messes and to pay for their meals. Members who are not obliged to pay or are not entitled to free rations may purchase meals at the mess.

15.129 The monthly charges for live-in members who are obliged to pay for meals are determined in accordance with Treasury Board regulations. The charges include the cost of the food and the civilian labour involved in its preparation and serving.

15.130 Our examination found that payroll deductions for rations were generally determined in accordance with the regulations and were properly collected and accounted for.

Emergency Assistance

15.131 The Department provides emergency humanitarian assistance and disaster assistance when requested by the provinces. Humanitarian assistance consists primarily of the transportation of sick or injured persons by air. Disaster assistance relates to such natural events as floods, forest fires and earthquakes.

15.132 The Order in Council that prescribes the charges for these services states that they are to be based on equivalent commercial rates, or the total cost of providing a service, unless it is an integral part of DND's programs, in which case no fee is to be charged. For humanitarian assistance to an individual, the charge may be reduced or waived altogether if it would cause hardship to the individual. The Order does not refer specifically to disaster assistance.

15.133 The Department charges only the incremental costs of both humanitarian and disaster assistance. Despite the reduced rates, a number of provinces have refused to acknowledge liability or to reimburse the Department for assistance. The unpaid accounts have increased over the years to $11 million, as of 31 March 1987.

15.134 This problem was originally noted in our 1963 Report. The Public Accounts Committee recommended in 1973 that the matter be given top priority at the next federal-provincial conference, but no action appears to have been taken.

15.135 In 1976, Treasury Board agreed to provide the Department with supplementary funding for direct out-of-pocket costs of emergency assistance. Since then, the estimated requirements have been included in the Estimates. The Estimates and the Public Accounts also cite assistance to civil authorities as an objective of the Department. As a result, these activities could be viewed as "an integral part of the Department's program" and therefore not eligible for recovery under the terms of the Order in Council. The Department was directed, however, to continue to attempt to recover the costs and to credit any receipts to non-tax revenue in the Consolidated Revenue Fund.

15.136 The matter received further consideration by interdepartmental committees in 1977 and 1979, but no changes occurred.

15.137 **The Department should review the basis for charging for humanitarian and disaster assistance and, in consultation with Treasury Board, should seek clarification or revision of the regulation to ensure that it is applied consistently to all provinces and that charges are either collected or written off in accordance with the applicable authorities.**

> ***Department's response:*** *The Department supports the recommendation of a review of policies related to humanitarian and disaster assistance. Until such time as the policy questions are resolved, the Department will continue the present method of accounting for services provided to the provinces.*

DEPARTMENT OF SUPPLY AND SERVICES

DEPARTMENT OF SUPPLY AND SERVICES

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16

DEPARTMENT OF SUPPLY AND SERVICES

Main Points

In 1986-87 the Department of Supply and Services (DSS) issued some $8.8 billion of contracts for goods and services on behalf of other government departments. Independent audit of government contracts by the Audit Services Bureau, on behalf of DSS, is important to ensure that costs and profits paid to contractors are fair and reasonable. (paragraphs 16.12 to 16.19)

In our opinion, certain aspects of contract audit coverage at DSS are deficient and do not provide adequate protection to the Crown. By comparison, government contract audit coverage in the United States is much more extensive. (16.20 to 16.42)

DSS did not have key summary information on the extent of contract audit coverage or the resolution of audit findings. Consequently, senior management could not properly assess the overall costs and benefits of the contract audit activity. (16.43 to 16.46)

We noted delays in resolving some contract audit findings, and disputes resulting from broadly worded contract costing terms. Also, DSS contract auditors were not informed of the resolution of their findings. (16.47 to 16.77)

For some major Crown projects, contract audits were delayed, and DSS contract auditors did not review the procedures used by the prime contractors in awarding significant subcontracts. (16.108 to 16.119)

The Audit Services Bureau is facing human resource problems and the contract audit approaches developed in the early 1970s have not been fully updated. (16.78, 16.79)

The Department believes that its present contract audit coverage continues to provide protection to the Crown. It is currently carrying out a review which is intended to assess the scope and extent of existing audit coverage and its adequacy for the future.

DEPARTMENT OF SUPPLY AND SERVICES

The Department

16.1 The Department of Supply and Services (DSS) was formed in 1969 as part of a general administrative reorganization of government in response to a concern for efficiency and economy in government spending.

16.2 Its mandate derives from the Department of Supply and Services Act, the Financial Administration Act, the Defence Production Act and numerous Orders in Council and Treasury Board Administrative Policies. In addition, DSS has several memoranda of understanding which govern its relationships with other departments and agencies.

16.3 In Part III of the 1988-89 Estimates, DSS describes its program objective as follows:

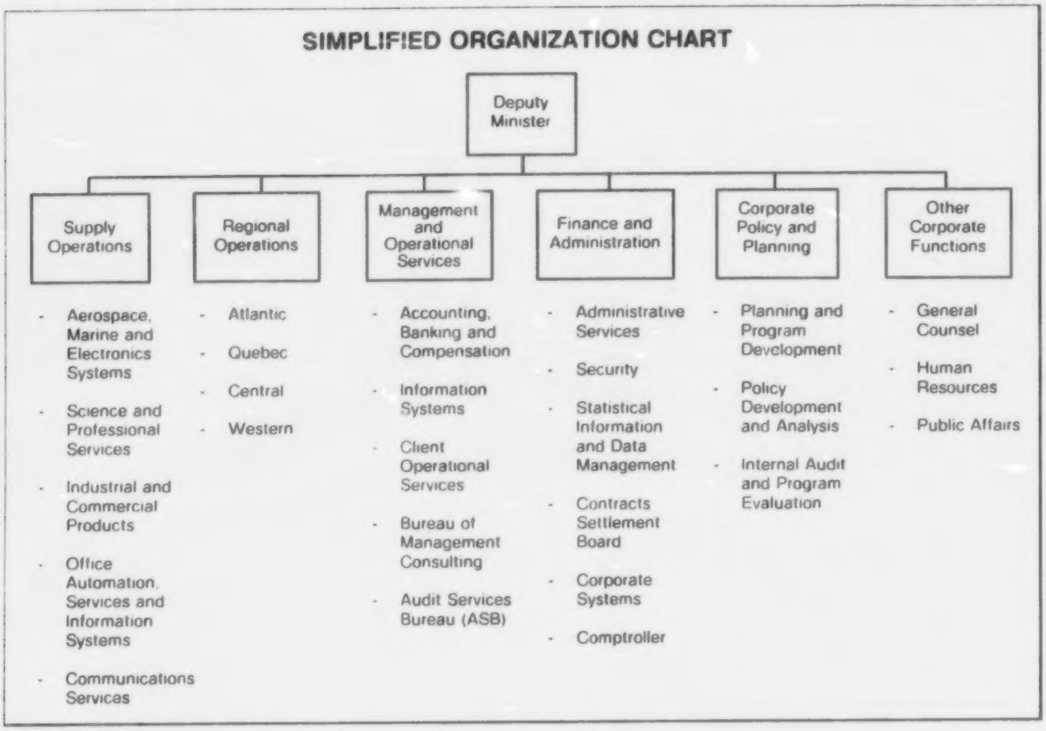
> To provide Receiver General programs in the areas of payment and banking services, maintenance of the central government fiscal accounts and associated reports; certain services in the area of compensation and personnel; and common services on a revenue dependent basis, for the supply of goods and certain services required by departments and agencies, and the disposal of Crown-owned material; all designed to enhance government efficiency, effectiveness and economy taking into account the contribution of these activities to the support of national objectives.

16.4 Within government, DSS is known as a common service organization providing goods and services to virtually all federal departments and agencies. These goods and services are delivered within a framework of policies established by the Treasury Board and with sensitivity to the broader strategic objectives of government such as regional or industrial development. According to Treasury Board policies, the primary role of common service organizations is the provision of service to their client departments and agencies and, within that role, the primary goal is the attainment of maximum value for money. In addition to Treasury Board policy and procedures, many of the activities of DSS are directed or constrained by other authorities such as the Minister of Finance or the governing legislation and policies of the individual departments and agencies DSS serves. Therefore, DSS activities are conducted in a complex environment where the objectives of service, control and value for money may conflict.

16.5 To deliver its various services, the Department employs close to 9,500 people and is organized into five major areas (see Exhibit 16.1).

16.6 The Supply Operations Sector is responsible for the overall management and direction of government procurement operations on a fee for service basis, including contracting for goods and services on behalf of other government departments and agencies and managing major Crown projects.

Exhibit 16.1



SIMPLIFIED ORGANIZATION CHART

Deputy Minister
Supply Operations
- Aerospace, Marine and Electronics Systems
- Science and Professional Services
- Industrial and Commercial Products
- Office Automation, Services and Information Systems
- Communications Services
Regional Operations
- Atlantic
- Quebec
- Central
- Western
Management and Operational Services
- Accounting, Banking and Compensation
- Information Systems
- Client Operational Services
- Bureau of Management Consulting
- Audit Services Bureau (ASB)
Finance and Administration
- Administrative Services
- Security
- Statistical Information and Data Management
- Contracts Settlement Board
- Corporate Systems
- Comptroller
Corporate Policy and Planning
- Planning and Program Development
- Policy Development and Analysis
- Internal Audit and Program Evaluation
Other Corporate Functions
- General Counsel
- Human Resources
- Public Affairs

16.7 The Management and Operational Services Sector is responsible for the overall management and functional direction of accounting, computing and related services to other government departments.

16.8 The Regional Operations directorates are the vehicle for day-to-day delivery of the Department's common services through a national network of District Supply and Services Offices.

16.9 The Finance and Administration Sector provides corporate financial and administrative support to the Department.

16.10 The Corporate Policy and Planning Sector provides planning, program direction, policy formulation and review, internal audit and program evaluation for the Department.

Scope of the Review

16.11 In our 1987 Report chapter on DSS, we reported on our evaluation of the management controls over common data processing services provided to other government departments and agencies and managed by the Management and Operational Services Sector of DSS.

Exhibit 16.2

VALUE OF CONTRACTS ISSUED BY DSS ON BEHALF OF OTHER GOVERNMENT DEPARTMENTS AND AGENCIES
(Fiscal Year 1986-87)

Customer Department	Value (billions)
National Defence	$ 4.8
Canadian Commercial Corporation	.7
Transport	.4
Regional Industrial Expansion	.4
Canadian International Development Agency	.2
Energy, Mines and Resources	.2
Environment	.2
Royal Canadian Mounted Police	.1
Fisheries and Oceans	.1
Correctional Services	.1
Agriculture	.1
Employment and Immigration	.1
National Research Council	.1
Public Works	.1
Health and Welfare	.1
Other customers	1.1
	$8.8

16.12 The objective of this year's review was to evaluate the adequacy of the procedures used by DSS to ensure that suppliers of goods and services comply with the terms and conditions of contracts awarded. We considered a selection of key conditions, including those pertaining to cost eligibility, contract audit, quality and timeliness of delivery, and Canadian content provisions.

16.13 The magnitude of government contracting is significant. In 1986-87 the Supply Operations Sector of DSS issued, on a fee for service basis, some $8.8 billion worth of contracts for goods and services on behalf of other government departments and agencies (see Exhibit 16.2). Current government plans call for major military procurement initiatives in the near future.

16.14 The first section of the chapter discusses our assessment of the adequacy of the contract audit activities of DSS. Contract audit is a key control mechanism employed by DSS to ensure contractor compliance with certain contract terms.

16.15 The second section covers our review of the procedures used by DSS to ensure compliance with selected terms and conditions of military repair and overhaul contracts. The last section covers the same areas with respect to two major Crown projects.

Departmental Contract Audits

16.16 Government contracts are often complex and frequently involve projects of significant value. Contracts are carried out by a prime contractor and many subcontractors, each of whom may participate in numerous government contracts as well as private sector work. In such an environment it is essential that only allowable costs are identified and charged to the appropriate government contract.

16.17 Under these conditions, the government bears the risk that improper charges, through error or misinterpretation, could result in significant overpayments. DSS policies, government contracts and the Defence Production Act provide the Department with the power and authority to ensure that costs and profits paid to contractors are fair and reasonable. For example, Section 19(2) of the Defence Production Act provides that:

> Where the Minister [of Supply and Services] is satisfied, either before or after the performance, in whole or in part, of a defence contract ...., that the total amount paid or payable thereunder to any person is in excess of the fair and reasonable cost of performing the contract together with a fair and reasonable profit, he may by order reduce the amount that such person is entitled to retain or receive thereunder to such amount as he may fix as the fair and reasonable cost of performing the contract together with a fair and reasonable profit thereon and the Minister may direct that person to pay to the Receiver General forthwith any amount that such person has received under the contract in excess of the amount so fixed.

16.18 To ensure that the prices paid are fair and reasonable in the circumstances, the Department verifies the costs and profits of contractors. An independent audit of contracts performed by the Audit Services Bureau (ASB) on behalf of DSS is one of the principal tools available to the Department to discharge its responsibilities.

16.19 The overall purpose of contract auditing is to provide an opinion on the extent to which costs and profits contained in a contractor's claim are:

- reasonable as to the nature and amount;
- allocable and measurable by the application of clearly stated cost accounting standards and generally accepted industry practices; and
- in accordance with applicable limitations or exclusions as stated in the contract terms and conditions.

16.20 The objective of our review was to assess the adequacy of the Department's contract auditing process through an examination of:

- the extent of contract audit coverage;
- the availability of centralized management information;

- the nature and disposition of contract audit findings; and
- the practices of another jurisdiction.

16.21 The review of another jurisdiction consisted of a comparison with the practices of the Defense Contract Audit Agency (DCAA), an independent agency of the United States Department of Defense. We do not suggest that the practices of other jurisdictions are entirely suitable within the Canadian environment. However, we believe that this comparison is very relevant to Canada, considering the concerns raised in government contracting in the United States in recent years.

16.22 Our review did not include an examination of the specific audit procedures or techniques used by the Audit Services Bureau in completing its work. These will be examined in future audits.

Extent of Contract Audit Coverage

16.23 It is fundamental that, for government contract audits to be effective, the extent of contract audit coverage must be adequate to protect the Crown.

16.24 In our opinion, certain aspects of contract audit coverage at DSS are deficient and therefore do not provide adequate protection to the Crown, both at present and for the future. Exhibit 16.3 sets out an estimate of the current DSS audit coverage. Exhibit 16.4 compares the contract audit coverage in Canada and the United States.

16.25 The following is an analysis, by type of contract, of the extent of contract audit coverage.

16.26 **Cost reimbursable contracts**. Cost reimbursable contracts are those where the contractor will be reimbursed for all eligible costs incurred in the delivery of the contracted goods or services. Such contracts generally provide for a profit to be paid to the contractor. These contracts are subject to cost audit, the intent of which is to allow the auditor to express an opinion that costs claimed by the contractor are fair, reasonable and in accordance with the contract terms.

16.27 Based on published DSS statistics, the value of cost reimbursable contracts issued by DSS is approximately $2.1 billion annually. Under current DSS practice, cost audits are limited to the cost reimbursable portions of major Crown projects and a sample of other contracts. Excluded are subcontracts that are awarded by the prime contractors on a competitive basis. The aggregate value of these subcontracts was not readily available.

16.28 At the time of our review, information on the percentage of cost reimbursable contracts awarded in a given year that were chosen for this type of audit was not readily available at DSS.

Exhibit 16.3

ESTIMATES OF THE EXTENT OF CONTRACT AUDIT COVERAGE UNDER CURRENT DSS PRACTICES

Type of Contract	Contracts Issued (1986-87) (billions)	Estimate of the Extent of Contract Audit Coverage
Eligible for Audit:		
Cost Reimbursable Contracts		
- Major Crown Projects	$ 1.0	All cost reimbursable contracts of major Crown projects are selected for audit except subcontracts awarded on a competitive basis.
- Other	1.1	Of the remaining cost reimbursable contracts approximately 35 percent are selected for cost audit.
	2.1 *	
Fixed Time Rate Contracts	0.7 *	Some control procedures are performed but virtually no independent audit.
Non-competitive Firm Price Contracts	2.4 *	The profits of only five contractors were audited by DSS in the last five years.
Not Eligible for Audit:		
Competitive Firm Price Contracts	3.6 *	Not eligible for audit. It is the policy of DSS not to audit competitive firm price contracts.
Total Contracts Issued	$ 8.8 *	

* The value of contracts issued is taken from published DSS statistics. We have estimated the split between non-competitive and competitive firm price contracts.

16.29 In the absence of such information, we estimated that the extent of annual contract audit coverage for cost reimbursable contracts is approximately 35 percent of total contract value, excluding the cost reimbursable portion of major Crown projects which, in accordance with DSS practice, are all selected for cost audit.

16.30 By comparison, in the United States, the practice of DCAA is that all cost reimbursable contracts require a cost audit before the contractor receives the final payment. In addition, where contract prices are negotiated, they will normally be subject to defective pricing audits on a sample basis (and 100 percent of such contracts over $50 million) usually within one year after a contract is awarded. Exceptions are where the price negotiated is based on adequate price competition, established catalogue or market price of commercial items sold in substantial quantities to the general public or prices set by law or regulation. The purpose of

Exhibit 16.4

COMPARISON OF CONTRACT AUDIT PRACTICES IN CANADA AND THE UNITED STATES

	Canada	United States
Contract Audit Coverage		
Cost Reimbursable Contracts	All cost reimbursable contracts of major Crown projects are selected for cost audit except subcontracts awarded on a competitive basis. Other cost reimbursable contracts are audited only on a sample basis (approximately 35 percent).	All cost reimbursable contracts are selected for cost audit. They are also subject to defective pricing audits which are conducted one year after awarding the contract to ensure that a contractor had provided accurate, complete and current financial data at the time the contract price was negotiated except where price competition is deemed adequate. Defective pricing audits are conducted on such contracts greater than $50 million and for a selection of smaller contracts.
Fixed Time Rate Contracts	Some control procedures are performed but virtually no independent audit.	All fixed time rate contracts are selected for cost audit. In addition, defective pricing audits are conducted on the same basis as above.
Non-competitive Firm Price Contracts	Profit audits are performed on a very exceptional basis. There have been only five such audits conducted in the last five years; all are still in progress.	Profit audits are not performed. However, defective pricing audits are carried out on these contracts on the same basis as above.
Competitive Firm Price Contracts	Not eligible for audit. It is the policy of DSS not to audit competitive firm price contracts.	Defective pricing audits are performed on the same basis as above.
Cost Accounting Standards	Highly summarized and general.	Highly detailed and specific.
Funding	Revenue dependent; that is, the cost of the audit is recovered from the contracting authority within DSS.	Audit costs are covered by direct appropriation from Congress.

defective pricing audits is to ensure that the contractor provided the government with accurate, complete and current financial data at the time the contract price was negotiated. When such audits determine that the government relied on inaccurate, incomplete or non-current data in negotiating a contract price, the contract price is reduced and appropriate interest and penalties are applied against the contractor.

16.31 **Fixed time rate contracts.** Fixed time rate contracts are those where the Crown pays the contractor for the actual hours incurred on the job multiplied by the fixed rate, usually hourly, stated in the contract. An example of this is paying a contractor for the repair and overhaul of government ships or aircraft on the basis of $xx per hour worked.

16.32 In 1986-87 DSS awarded close to $0.7 billion worth of fixed time rate contracts, a significant portion of which was for military repair and overhaul work. Our review noted that, over the past few years, ASB has performed virtually no independent audits of this type of contract, although other control procedures were performed as described in paragraphs 16.102 to 16.104.

16.33 In the United States these fixed time rate contracts are considered cost reimbursable and, as a result, are all selected for cost audit. In addition, they are also subject to defective pricing audits to the same extent as described for cost reimbursable contracts.

16.34 **Non-competitive firm price contracts.** Firm price contracts, which involve the purchase of goods and services at a fixed price, may be awarded without tender for a variety of reasons, such as only one supplier having the expertise. DSS policies allow for the review of these contracts to ensure that the average profit realized by the contractor on all applicable government contracts over a period of time, usually five years, is not excessive. These reviews are known as contract profit audits.

16.35 Information on the value of contracts that could be subject to profit audit was not readily available at DSS. We estimate that these types of contracts could be approximately $2.4 billion annually. Despite this significant amount, we found that, during the last five years, DSS audited the profits of only five contractors. All these audits were still in progress at the time of our review.

16.36 We believe the Department's current practice of reviewing profits realized by a contractor over a five-year period is expensive to carry out and needs to be revised. In our view, more economical coverage could be achieved by reviewing, for a sample of contracts, profits realized on an individual contract basis.

16.37 In the United States, DCAA does not perform profit audits. However, it does conduct defective pricing audits on these types of contracts on the same basis as explained in paragraph 16.30.

16.38 **Competitive firm price contracts.** This is the term used to describe procurement contracts, where the price to be paid to the contractor is determined by market forces. A number of contractors bid on a specific contract, with the contract being awarded to the best overall bid, based on price and other factors.

16.39 We noted that the Department classifies some $3.6 billion annually as competitive firm price contracts, excluding them from audit under its current practice. We are concerned by the fact that some of the contracts included in this category may not have been awarded under true competitive market conditions, for example in situations where negotiations of some aspect of the contract price take place after the tender process is complete. In these instances, competition and the market forces have not had an opportunity to work and thereby ensure fair and reasonable prices and profits. In our view, such contracts should be eligible for audit selection. We were unable to quantify the extent of this situation because the Department did not have the necessary information.

16.40 As described in paragraph 16.30, the DCAA in the United States performs defective pricing audits where the contract price was negotiated, except where price competition is deemed adequate.

16.41 As shown in Exhibit 16.4, the contract audit practices of the United States DCAA are more extensive than those of DSS. It would be appropriate for DSS to determine an optimum mix and coverage of contract audit somewhere between the Canadian and American practices, provided that the cost of audit does not exceed its benefit.

16.42 Concurrent with the start of our review, the Department established a study group to examine the adequacy of contract audit coverage. By the end of our review, and up to 26 July 1988, DSS indicated that this study was still in progress. However, its preliminary findings indicated that "there is a problem with audit focus, and the need to determine an annual audit mix to ensure optimization of audit effort". In addition, we noted that the Department has recently increased its contract audit budget.

Management Information

16.43 Centralized management information, summarized and reported on a regular basis, is necessary if informed decisions are to be made by senior management on the appropriate nature and extent of contract audit coverage.

16.44 At the time of our review, while some basic contract audit information was available, DSS did not have key summary information readily available on such things as the extent of contract audit coverage and the resolution of reported audit findings. Performance information for the contract audit activity, such as the savings resulting from contract audit findings versus the cost of such audits, and audit findings as a percentage of total contracts audited, were not generally available at DSS. The lack of such summary information resulted in senior management of DSS not being able to properly assess the cost-benefit of the contract audit process or determine whether the current contract audit coverage provides adequate protection to the Crown. In our opinion, ad hoc studies are not a substitute for the regular flow of key summary information required for decision making by senior management.

16.45 We found that, in the United States agency, information on such measures is maintained, summarized and used by senior management for contract audit resource justification and in strategic audit planning.

16.46 Concurrent with our review of this area, DSS has been taking steps to improve the availability of contract audit management information.

Review of Contract Audit Reports

16.47 The prompt follow-up and resolution of audit findings is an important step in ensuring that the interests of the Crown are adequately protected.

16.48 We selected a sample of contract audit reports conducted by DSS in the past two and a half years and reviewed them to determine whether the audit findings were acted on promptly and their disposition fully documented. We found that findings in approximately 70 percent of the contract audit reports we examined had been resolved. The remaining reports either had not been resolved or their resolution had been delayed for between one and three years. The following is an analysis of some of the reports we examined, together with illustrative cases.

16.49 **Contract Interpretations.** A basic premise of contract management is that all terms and conditions of the contract should be clearly stated and should accurately reflect the intent of the parties to the contract.

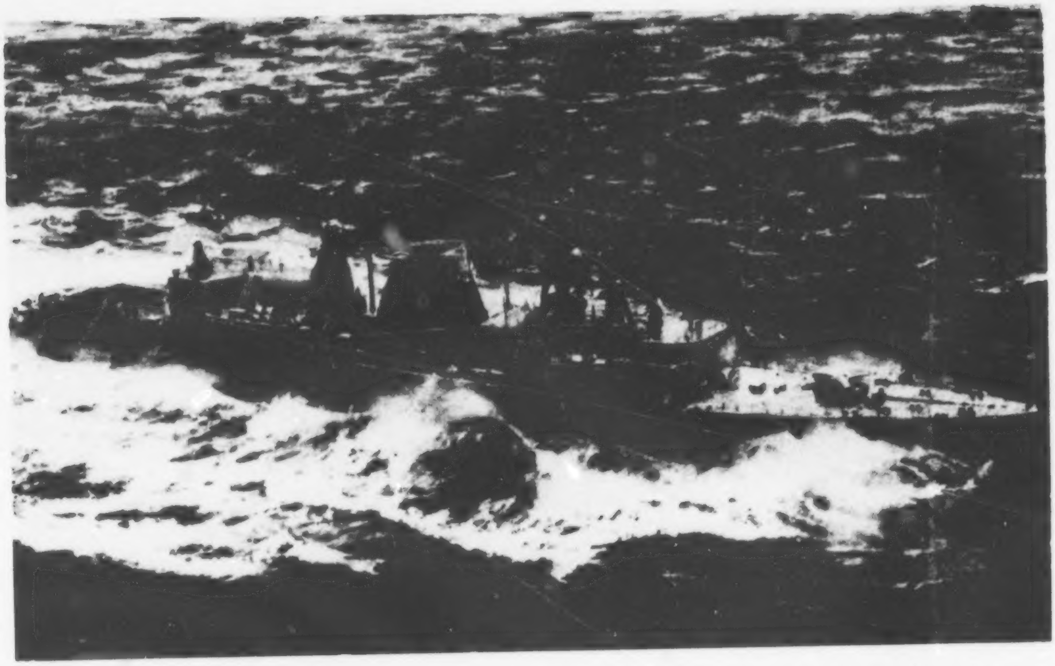
16.50 We noted disagreements over some audit findings among ASB auditors, DSS contracting officers and the contractor. The reasons for these conflicts included broadly defined contractual terms and conditions relating to cost definitions, which allow for different interpretations of allowable costs, and contracts which inadequately reflected the intent of negotiations. The following is an example of such a disagreement.

16.51 **Case 1.** The Canadian Patrol Frigate (CPF) contract dated July 1983 sets out in general terms the categories of costs that will be eligible for reimbursement, the costs that will be specifically excluded and the costs eligible for overhead determination. In January 1985, DSS negotiated a supplementary overhead agreement with the contractor which included detailed schedules of how overhead costs were to be determined and allocated, during the period from contract signing in July 1983 to the time when construction of the frigates started in June 1985.

16.52 As a result of an ASB audit report issued November 1987, there was disagreement between the DSS contracting officers and the ASB auditors over how shipyard overhead costs were determined and charged to the CPF project during the pre-construction period. The disagreement, which existed at the time of our review, centred on whether this overhead agreement represented a new basis for determining overhead costs, resulting in the Crown paying the contractor approximately $10 million which was not in accordance with the cost provisions of the original contract.

16.53 DSS is of the view that the supplementary overhead agreement did not alter the basis of payment, but only provided clarification of the intent of the original contract negotiations.

16.54 In addition, on 20 July 1988, the Department stated that in its view the cost terms of the CPF contract were an:



An artist's conception of one of the twelve Canadian Patrol Frigates (CPF) currently under construction at a total cost not to exceed $6.2 billion (see paragraphs 16.51 to16.56 and 16.108 to 16.130).

expansion of the cost policy DSS uses to define costs eligible for inclusion in its contracts, and for which the overhead agreement provided further clarification. The reimbursement of the costs incurred by the contractor in maintaining the shipyard in a state of readiness before the construction of the ships could begin was within the authority of the Department, as provided by the CPF contract.

16.55 In our view, it is an unacceptable weakness in the system of internal control when the cost terms of a significant government procurement contract are so broadly worded that they allow a variation in the interpretation of allowable costs amounting to $10 million.

16.56 This type of disagreement could be avoided if DSS replaced the current general cost accounting policy with a more detailed one which would also require contractors and subcontractors to provide the contracting authority with a disclosure statement of their cost accounting practices. This disclosure statement could then be reviewed by the contracting authority or by the auditors. Disagreements identified during this process could be remedied, or the contract could be reworded to clearly reflect the intent of the parties.

16.57 **Contractor accounting records and other matters.** The Defence Production Act, DSS policies and contract terms all require contractors to maintain adequate accounting records and to provide information as required by DSS.

16.58 Problems noted by ASB in this regard include:

- inadequate contractor records, for example lack of segregation of costs and weak commitment control; and
- delayed or non-delivery by contractors of required documents such as formal cost submissions and outstanding purchase order lists.

The following cases illustrate these problems.

16.59 **Case 2.** A contractor was awarded a number of annual contracts to purchase spare parts for the repair and overhaul of certain government-owned aircraft. Under the terms of these contracts, the contractor is reimbursed for the cost of the spare parts against the contract under which they were ordered.

16.60 In a report dated April 1986, ASB noted that the contractor had improperly charged some $970,000 of spare parts to the wrong contracts. We found in reviewing DSS files that the contractor's accounting records did not allow for proper commitment control over these spare part contracts and that the contractor did not, as required by the contracts, provide the Department with a list of outstanding purchases at the end of each contract. As a result, the contractor had been ordering parts in excess of the financial limits of a number of contracts and was claiming for these parts against subsequent contracts. Our review of other spare parts contracts with the same contractor indicated similar deficiencies.

16.61 During our review we brought this case to the attention of the responsible DSS contracting officer. He reviewed the situation and finally concluded, in internal memoranda dated 31 March 1988 and 7 April 1988, that, although costs were fairly and properly incurred by the contractor, they were, in some cases, improperly billed against the wrong contract. Contract amendments issued by DSS in June 1988 allowed the charging of the improperly billed amounts. The contracting officer indicated that the improper billing practices have ceased, starting with 1987-88 contracts, due to recent changes in the contractor's accounting system.

16.62 **Case 3.** A repair and overhaul contract was awarded to a contractor effective from July 1983 to June 1984. Total payments under this contract amounted to $424,000.

16.63 We noted from DSS files that the contractor was not keeping proper books and records in accordance with general contract terms, and had not done so for several years, at least as far back as 1981. On completion of our review, DSS advised us that this problem had been remedied in June 1984.

16.64 However, ASB reported in January 1987 that documentation supporting costs could not be located and that claimed costs were improperly based on estimated amounts. The result was an overclaimed amount of $46,000. During our review we brought this case to the attention of DSS officials who, on 16 March 1988, requested the contractor to resolve this matter. DSS later informed us that the contractor had justified costs of $29,000 and had agreed to remit the remaining overpayment of $17,000. Because this settlement occurred after the completion of our review, we were unable to verify the basis on which it was made.

16.65 **Contract audit reports relating to the Defence Industry Productivity (DIP) Program.** The Department of Regional Industrial Expansion (DRIE) administers the DIP Program to develop and maintain strong defence related industries across Canada.

16.66 DSS is a participant in some aspects of the administration of this program. Its role is governed by a 1981 memorandum of understanding between DSS and DRIE's predecessor department, Industry, Trade and Commerce; DSS written policies; DRIE's internal program directive; specific contract clauses; and the involvement of the Audit Services Bureau.

16.67 Among other things, DSS is responsible for preparing and signing contribution agreements, ensuring contractor compliance with those agreements, arranging for the audit by ASB of claimed costs, and certifying progress claims.

16.68 We asked DRIE officials about its role in resolving audit issues contained in ASB reports. We were advised that its role is outlined in the internal DIP Program Directive which states that "...DRIE is responsible for the disposition of all audit qualifications raised by DSS..."

16.69 We reviewed a sample of ASB contract audit reports related to the DIP Program. ASB addressed these to DSS with copies provided to DRIE. We noted that action on 50 percent of these reports was either delayed or not resolved at the time of our review, even though some of them were dated as far back as December 1985. The circumstances relating to two contractors, who were the subject of several contract audit reports which had not been resolved at the time of our review, are discussed in the following illustration.

16.70 **Case 4.** A contractor, under terms of three contracts, was to be reimbursed by the Department of Regional Industrial Expansion for a portion of the cost of developing aircrew training equipment.

16.71 The contractor was not able to adequately segregate certain development costs which were eligible for reimbursement by the Crown.

16.72 In its interim audit reports dated December 1985, ASB estimated that the government had overpaid the contractor an amount of about $1 million. The reasonableness of this estimate was disputed by the contractor. In January 1986, ASB requested DRIE's concurrence with the basis of its estimates. At the time of our review in March 1988, the dispute with the contractor had not been resolved.

16.73 We were advised by DRIE that "overclaimed amounts are not normally collected based on interim audits if it is believed that the overclaim will disappear on final audit". Subsequent to our review, in July 1988, DRIE reported that, after considerable discussions with the contractor in this case, the disputed items were resolved. DRIE indicated that the estimated overclaim on these contracts, amounting to $366,000, was billed to the contractor in June 1988.

16.74 We are concerned that more than two years passed before the issues were resolved, during which time the contractor retained the estimated overclaim of $366,000. We question the usefulness of contract audits if action on significant findings is delayed.

16.75 In a similar case with another contractor, DRIE indicated that it had requested DSS to resolve disputed issues relating to overhead costs which had resulted in overclaims. Although these disputes were identified in ASB reports dated as early as July 1986, January 1987 and March 1987, they had not been resolved by the end of our review. DRIE advised us that it expects resolution of these issues and final audit to be completed by October 1988.

16.76 Thus, we are concerned that for DIP Program contracts, which represent approximately 15 percent of ASB contract audit activity, arrangements are inadequate between DSS and DRIE to ensure that ASB audit report findings are promptly resolved.

16.77 After the completion of our review, in July 1988, DRIE reported that it had instituted a follow-up system to ensure that audit findings on final reports are disposed of expeditiously and that DSS is advised of the disposition. In addition, DRIE stated that, although the responsibility for the disposition of audit findings on the DIP Program rests with DRIE, the practice has been unclear with respect to cost provisions of the DSS Contract Cost Principles (DSS 1031-1). In order to clarify these responsibilities, officials of DRIE and DSS met and confirmed in writing on 7 July 1988 that audit issues involving interpretation of the Contract Cost Principles should be resolved by DSS, as cost interpretations apply to other government contracts and precedence and consistency need to be considered.

Contract Audit Environment

16.78 In examining the contract audit environment, we found that ASB is facing some problems in the area of human resources. Recent ASB strategic planning documents indicated that ASB has undergone continuous downsizing since 1974 and that there is a need to stabilize and rejuvenate the ASB organization.

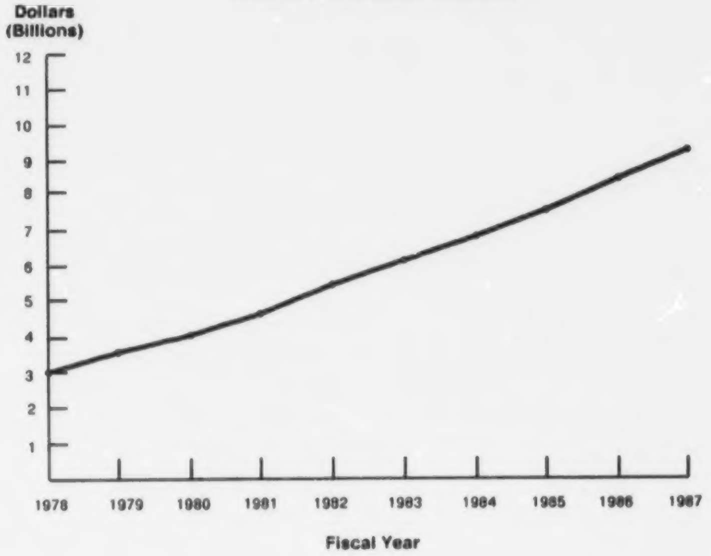
16.79 While the value of government contracts issued by DSS during the past decade has been increasing, as shown in Exhibit 16.5, the contract audit effort, expressed in audit hours, has stagnated over the same period. In addition, there have been reductions in the training and research budgets at ASB. Consequently, the contract audit approaches developed by the organization in the early 1970s have not been fully updated. We were advised that DSS is currently addressing the human resource problems of ASB.

16.80 **The Department should determine and implement the optimum mix and coverage of contract audit, while ensuring that the cost of such audits does not exceed their benefits.**

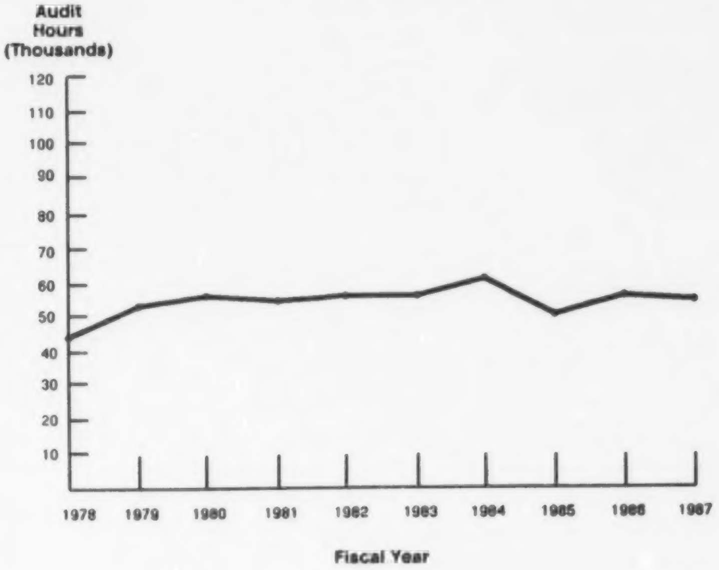
16.81 **The Department should develop a centralized management information system which summarizes and regularly reports key contract audit information to**

Exhibit 16.5

COMPARISON OF GOVERNMENT CONTRACTS ISSUED AND CONTRACT AUDIT HOURS



Trend in Government Contracts



Contract Audit Hours

senior management. This should include summary information on the extent of audit coverage, the overall results of contract audits, cost-benefit analysis, and other measures of performance of the contract audit process.

16.82 All contract audit findings and audit reservations should be promptly resolved, and the disposition of the findings communicated to the Audit Services Bureau and senior management of the Department.

16.83 To reduce the possibility of misinterpretation of contract cost provisions, DSS should develop a more explicit cost accounting policy, particularly for the larger and more complex projects. DSS should require contractors to disclose their cost accounting practices as part of the contractual terms and conditions.

16.84 During the course of our review we communicated the above matters to senior DSS officials. On 30 June 1988, we were advised by DSS that many of these matters were being considered in departmental studies which are expected to be completed later in 1988.

Repair and Overhaul

16.85 The Department of Supply and Services has responsibility for the procurement of repair and overhaul services related to aircraft, ships, armament and accompanying systems. Contracts issued by DSS during 1986-87 relating to these services approximated $577 million.

16.86 The objective of our review was to assess the adequacy of procedures used by DSS to ensure contractor compliance with selected terms and conditions of military repair and overhaul contracts.

16.87 Our work concentrated on military repair and overhaul contracts issued by DSS during the past four years and included contracts having a total value of $218 million.

Reporting of Contractor Compliance

16.88 Senior managers at DSS place considerable reliance on the individual contracting officers in monitoring contractor compliance and resolving problem cases. Although their work is necessary, there is no routine reporting of the summary results of their monitoring to senior managers. Such reporting could include a summary of the frequency and impact of contractor non-compliance in specific areas such as technical quality standards and cost control. This could help DSS maintain its corporate memory and formulate or improve its contractual terms and conditions or its policies and procedures relating to them.

Technical Quality Assurance of Materiel and Services

16.89 A formal policy exists which establishes the division of responsibilities between the Department of National Defence (DND) and DSS for the technical quality assurance of military repair and overhaul services acquired on behalf of DND. The primary responsibility for setting technical specifications and ensuring product quality rests with DND. However, DSS policy specifically requires it to ensure that selected contractors have acceptable quality assurance and inspection systems in place. DSS also has overall responsibility for contract award and management. In addition to a written division of responsibilities, close co-ordination between DND and DSS is essential throughout the entire life cycle of repair and overhaul projects.

16.90 We reviewed 15 contracts, having a value of $166 million, for compliance with contractual technical quality specifications. In the two cases described below we noted, from DSS files, significant deviations from technical standards relating to safety or operational requirements. The value of the contracts in which these deviations occurred was $38 million. Because the responsibility for applying technical standards, and thus for ensuring product quality, belongs to DND, our review concentrated on the contract management function within DSS.

16.91 As previously noted, DSS does not have a summary reporting system to capture the frequency and nature of technical quality deviations. Consequently, the total extent of these deviations cannot be readily determined. However, we believe these cases demonstrate that, when contractor compliance in this area is not obtained, the consequences can be significant.

16.92 **Case** 5. For the past 15 years, a contractor has had responsibility for repair and overhaul of Buffalo aircraft components. Effective January 1987, DSS entered into a $4.7 million contract with this contractor to provide for the repair and overhaul of hydraulic system spares of various aircraft in accordance with DND-approved technical orders. Payments to March 1988 amounted to $1.7 million.

16.93 Our review of DSS files disclosed problems involving failure to conform to technical requirements.

16.94 DSS knew, before the effective date of the contract, that the contractor could not always comply with DND technical orders. We were advised that a contributing factor to the non-compliance was the inadequate equipment used by the contractor in performing the necessary services.

16.95 In addition, as a result of ongoing delays in obtaining proper parts, certain aircraft were grounded and in some cases robbed for parts. We were advised that these aircraft are 15 to 20 years old and are designated for search and rescue missions, both military and civilian. DND indicated to us in July 1988 that the lack of operational aircraft did not hinder any search and rescue missions.

The Buffalo aircraft is normally used for military and civilian search and rescue missions (see paragraphs 16.92 to 16.98).

16.96 We further noted from DSS files that, in August 1987, DSS reassigned some of the work to another contractor to meet a critical requirement.

16.97 For another aircraft, the Aurora, late deliveries of landing gear assemblies by this contractor resulted in claims for idle time by another contractor. DSS files showed that the cost of idle time was $75,000, while DND indicated, after completion of our review, that it was $41,000.

16.98 We were advised by DSS officials that the difficulties experienced in this case were attributable, in part, to a lack of sufficient competition in the area of repair and overhaul procurement and that they are attempting to increase this level of competition.

16.99 **Case 6**. During the period April 1984 to March 1986, a contractor held a contract with DSS to inspect and repair Sea King helicopters. The value of the contract, which was subsequently extended to March 1989, is $33.9 million. The work included painting the aircraft as required.

16.100 In February 1985, DND identified a paint adhesion problem on two helicopters, which it considered was serious enough to pose a flight safety hazard. While tests were being conducted on suspected defective paint batches, the contractor was instructed to repaint the aircraft. Test results in December 1985 were inconclusive, and by March 1986 the cause of the problem had still not been clearly established.

16.101 Notwithstanding the lack of resolution of this matter for over a year, DSS agreed to pay claims for the total cost of repainting the aircraft. This resulted in an additional payment of $162,000 even though DSS had not determined, at the time of our review, the liability for the problem.

Time and Cost Verification

16.102 DSS policy establishes mandatory time and cost verification procedures for all fixed time rate contracts throughout the duration of the contracts and before the final progress claim is processed for payment. These procedures include verification of time claims for acceptability and for accuracy of recording. They also require the cost analyst and the contract manager to place on file their written certification that, as established by their reviews, the contractor's time recording procedures are acceptable and time charged to the contract is appropriate.

16.103 We reviewed 14 files that had a total contract value of $164 million, with an estimated fixed time rate portion of $92 million. Only one of the files contained the required certification. We noted that about half of these contracts had expired and others had been extended.

16.104 Documentation obtained from DSS indicated that, during the period July 1986 to December 1987, only 17 contracts with a total value of $6.5 million were subjected to time verification procedures. DSS later informed us that the error rate in these 17 contracts was negligible and that, in any event, the Department did not maintain complete records on the total number of verifications. We did not verify the reported error rate. However, we noted from internal memoranda dated November 1987 and March 1988 that DSS officials were concerned about the insufficiency of the time verification procedures. The concerns raised in these internal memoranda did not appear to be consistent with the low error rates reported by DSS.

16.105 In addition, as previously described in paragraphs 16.31 and 16.32, we noted that virtually no independent audit has been performed on fixed time rate contracts, amounting to $0.7 billion, which are largely for repair and overhaul.

16.106 **To enhance the management of repair and overhaul contracts, DSS should use its existing computer capabilities to capture and report to senior management summary information relating to suppliers' non-compliance with key terms and conditions of these contracts.**

16.107 **DSS should review and implement its policies and practices with respect to fixed time rate contract cost verification.**

Major Crown Projects

16.108 We reviewed two major Crown projects, the Tribal Class Update and Modernization Project (TRUMP) and the Canadian Patrol Frigate (CPF) project, both of which are part of the naval modernization program of the Department of National Defence.

16.109 Each project is governed by a multiple incentive, ceiling price contract, which is subject to price escalation clauses. Key contract information is set out in the following table.

	TRUMP	CPF
Ceiling price	$ 946 million	$ 6.2 billion
Target cost	841 million	4.6 billion
Payments to January 1988	283 million	1.9 billion
Date contract signed	May 1986	July 1983
Last delivery date	1992	1996

16.110 Our review considered the Department's procedures for monitoring the contractors' compliance with certain terms and conditions of the contracts, including verification of costs claimed, progress of the projects and compliance with industrial benefits requirements.

Verification of Costs

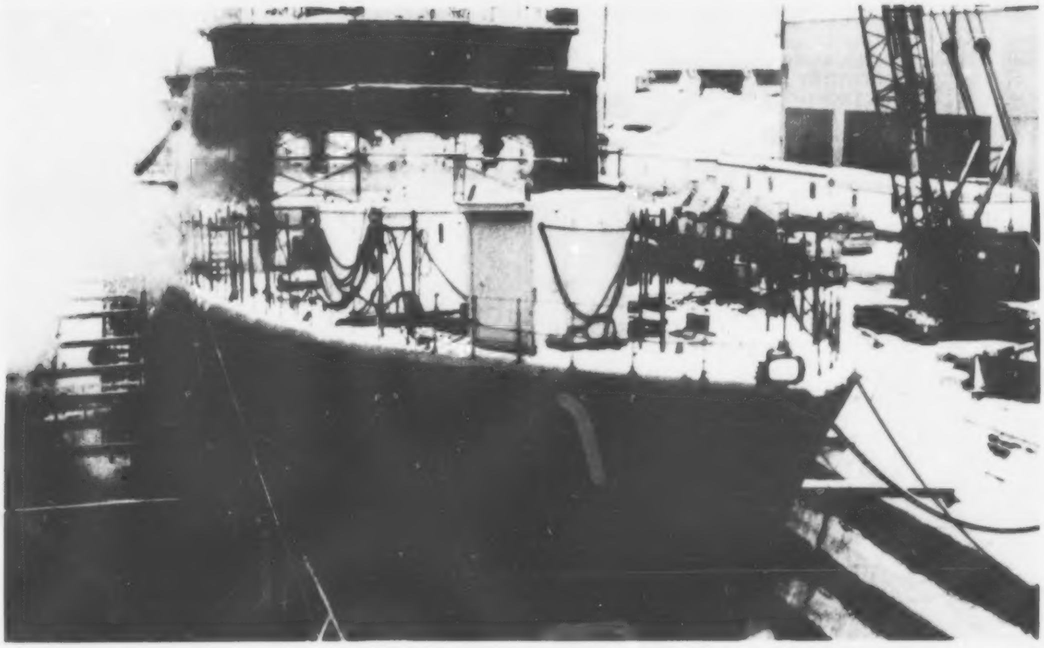
16.111 Cost verification procedures are carried out by the Department's project officers. They are designed to ensure that progress claims submitted by the contractor are supported by evidence of eligible costs incurred under the contract. These procedures involve a review of the progress claims and supporting documentation for arithmetical accuracy and cost approval, and are augmented by site visits and inquiries. For milestone claims, a technical quality review is required to ensure satisfactory completion of the milestone work elements.

16.112 These procedures, while useful, are not an adequate substitute for an independent audit of contractor costs and profits. That is why DSS policies provide for independent audits of these major Crown projects.

Contract Audit of Major Crown Projects

16.113 Both the TRUMP and CPF contracts provide for independent audits. Under current DSS practice this means that cost reimbursable contracts of major Crown projects are selected for audit. Contracts awarded by the prime contractor to subcontractors on a competitive basis are reviewed and approved by DSS officials but are not subject to independent audit.

16.114 Our review noted delays in starting audits of prime contractors and their subcontractors. In addition, DSS independent contract auditors do not review the procedures used by the prime contractors in awarding significant subcontracts.



This is one of four navy destroyers to be refitted and modernized under the Tribal Class Update and Modernization Project (TRUMP) at a cost not to exceed $946 million (see paragraphs 16.108 to 16.130).

16.115 For TRUMP, DSS requested two audits by ASB in September 1986 and three more in January 1988. We are advised by DSS that, in the case of competitive firm price TRUMP subcontract procurement, no auditing is planned except in the event of unexpected subcontractor termination. Thus, of the $283 million paid to contractors during the period May 1986 to January 1988, approximately $213 million is not eligible for contract audit under current DSS practice. Of the remaining $70 million, only one audit covering approximately half a million dollars of expenditures has been reported on. The remaining audits were still in process at the time of our review.

16.116 In the CPF project, the audit of the amounts paid to the prime contractor during the period from 1983 to 1985 was not completed by ASB until November 1987. This audit report indicated that an amount approximating $100 million paid by the prime contractor to subcontractors had not been audited by ASB. ASB did not know whether the subcontracts were awarded on a competitive basis and asked DSS for direction. At the time of our review, no direction had been given.

16.117 Similarly, an ASB report dated February 1987, which examined payments to the Class I subcontractor who is providing the combat systems suite, indicated that $260 million paid to non-affiliated subcontractors and suppliers during the period July 1983 to March 1986 had not been audited. ASB auditors are not certain whether these contracts were awarded on a competitive basis and have requested direction from DSS. Up to the time of our review, no direction had been given.

16.118 With respect to amounts paid to U.S. based affiliated companies, ASB has requested the U.S. Defense Contract Audit Agency to audit these amounts. To date, one audit report has been received covering 50 percent of the amounts, with the remaining audits still in process.

16.119 DSS officials indicated to us, on 30 June 1988, that they were in the process of reviewing the subcontracts referred to in paragraphs 16.116 and 16.117, to determine whether they should be subject to audit.

Canadian Industrial Benefits Verification

16.120 Contractors are required to provide industrial benefits to Canada over the duration of projects. These benefits take the form of "Canadian content values" and "offset provisions". Contracts contain criteria and definitions for calculating industrial benefits and determining where they are to be achieved. For example, the TRUMP contract requires the contractor to provide industrial benefits to Canada amounting to 100 percent ($841 million) of the target cost of the contract. It also provides for penalties of 10 percent of the amount of any shortfall in industrial benefits. To demonstrate the achievement of industrial benefits, the main contractor is required to provide regular reports to DSS.

16.121 The Department of Regional Industrial Expansion (DRIE) performs reviews and verification of the industrial benefit claims contained in these reports. With respect to TRUMP, DRIE contracted with ASB, in the fall of 1987, for a verification of claims made from the project's inception in May 1986 to March 1987. Industrial benefits amounting to $59.3 million had been claimed for this period. The scope of ASB's verification was limited to a review of the main contractor's claims for $16.3 million worth of industrial benefits. ASB reported a small error in these claims. However, it also raised several reservations respecting the claims. These reservations related to:

- the inability to verify specific cost information prepared by the main contractor because this information was not part of the normal cost accounting system;
- the non-verification of subcontract costs;
- the inadequacy of identification of distribution agents for non-Canadian suppliers; and
- the inclusion of unaudited internal overhead rates in costs.

16.122 In our view, the limited scope of ASB's work and its reported reservations are serious enough to preclude a meaningful conclusion on the achievement of Canadian industrial benefits for the period reviewed. DRIE has indicated that, as a result of the ASB work, the main contractor has been instructed to modify its cost accounting system. In addition, following our review, DRIE included in its 1988-89 audit plan a sample of subcontracts for audit by ASB.

16.123 DSS and DRIE officers raised several concerns during 1987 and 1988 about the verifiability of industrial benefits claimed by the main contractor. In particular, certain information submitted in support of the achievements claimed was incomplete or incorrect. Furthermore, internal findings revealed that the main contractor did not track Canadian content as required by the contract, and DSS questioned whether the percentage of industrial benefits claimed had been achieved. DRIE has indicated that these matters have since been remedied.

Progress of Work

16.124 The role of DSS in the management of major Crown projects includes monitoring progress under the contract, ensuring compliance with its terms and conditions, and responding to problems as they develop. DSS uses several methods to control contractor performance. These include conducting regular reviews to determine and monitor the progress contractors have reported; requesting, where necessary, that contractors develop work plans to ensure projects catch up with contracted schedules; and withholding payment of progress and milestone claims. In addition, DSS requires contractors to implement a comprehensive scheduling system that will integrate information on all aspects of the project. This system is to assist contractors and DSS management in monitoring the progress of the work.

16.125 **Information for project management.** For TRUMP, the implementation of the Cost/Schedule Control System by the main contractor and selected subcontractors is a year behind schedule. Notwithstanding the procedures described in paragraph 16.124, an internal report dated March 1988 concluded that continuing delays in meeting the contract requirements for full implementation of this system reduce the usefulness of progress reports and cause incomplete plans and status reporting. DSS is concerned that the information provided by the system is deficient and does not give an adequate picture of project scheduling. As a consequence, management decisions are made more difficult with the information currently provided.

16.126 While such problems were encountered in the early stages of the CPF Project, they have been resolved and project management is now satisfied with the information it is receiving.

16.127 Both major Crown projects have seen considerable slippage in meeting contractual milestones. For example, in TRUMP only four of the eight performance milestones which were to be completed by the end of February 1988 were reported as having been met. In the CPF Project there have been two major amendments to the milestone schedules. These amendments, caused primarily by revisions to the engineering methods being used in the construction of the frigates, have been accompanied by the imposition of liquidated damages against the contractor for the delay in progress of the work.

16.128 One measure for determining the impact of these problems on performance of the contract is a comparison of estimated costs of completion with original target costs. As of January 1988, DSS estimates that the costs of completing the first six frigates will exceed their target cost, but not the ceiling price, by approximately 10 percent or $235 million.

16.129 Similarly, the performance trends in TRUMP indicate continuing difficulties in meeting planned schedules. DSS anticipated in its March 1988 project report a potential target cost overrun as the contractor uses more resources in attempting to make up a four to six month delay in the provisional acceptance of the first vessel. However, we were informed by DSS on 20 July 1988 that "...the Department estimates that the contractor will be under the ceiling price by approximately two-thirds of the difference between the target and ceiling prices".

16.130 **Project reporting.** We were pleased to note that DSS has implemented procedures for reporting to senior management the status of the projects. These reports, which are intended to bring to their attention current problems or issues with which DSS is dealing, are providing this type of information. While we noted that DSS officials have expressed in the reports several concerns relating to project management, we were advised by them that these are normal day-to-day problems faced in major Crown projects and that they are being dealt with. We are concerned, however, that the kind of difficulties encountered to date may result in cost escalations or overruns toward project completion. However, DSS assured us that both the TRUMP and CPF projects will be completed substantially below the ceiling price.

16.131 **When prime contractors of major Crown projects subcontract a significant portion of the work through competitive tender, the role of DSS independent contract auditors should include a review of the procedures used by the prime contractor to ensure that these subcontracts were awarded on a truly competitive basis.**

16.132 **DSS audits of non-competitive and cost reimbursable major Crown projects, including subcontractors and significant transactions with suppliers, should be conducted without delay.**

16.133 **DSS and DRIE should ensure that full compliance with industrial benefit contract requirements is obtained.**

Department's Response

The present contract audit coverage carried out by the Department continues to provide protection to the Crown in ensuring that contractor costs and profits are fair and reasonable. As a part of its normal contract administration practices, the Department is carrying out a review which is intended to assess the scope of audit, the degree of coverage within that scope which is in practice today, and its adequacy for the future. Should the review indicate the necessity, changes will be made.

Information on the results of cost audit activity has been available and has guided us in decision making in our coverage. There is a continuing process of revising management information systems in the Department and, as we revise and expand this system, the suggestions of the Auditor General will be incorporated.

The prompt follow-up and resolution of audit findings will continue to be emphasized. The appropriate information will be provided to the Audit Services Bureau on a regular basis.

The Department considers that the current cost accounting policy provides the appropriate guideline within the Canadian contracting environment. DSS continually monitors this area and issues interpretation bulletins for use by procurement officers as the procurement environment changes. These guidelines provide significant flexibility to the Department in disallowing costs which are not appropriate, and there have been very few misinterpretations over the years. Unlike the U.S., we do not have a requirement for contractors to formally disclose their cost accounting practices. We do review their cost accounting systems in all non-competitive contract situations.

In the area of repair and overhaul activity, DSS has been developing and testing the Procurement and Acquisitions Support System (PASS). The feasibility of using it to capture and report summary contractor performance information will be examined. The area of verification of fixed time rate contracts will be reviewed, and in the event changes are required to either policy or practices, they will be made.

With regard to the major Crown projects, when necessary to ensure that the interests of the Crown are protected, the Project Office established to manage each major Crown project reviews the subcontracting procedures used by the prime contractor. Independent cost auditors are not in a position to carry out this type of determination; therefore, DSS uses procurement officers who are familiar with all aspects of the work and the supplier environment. In addition, significant subcontracts must have the concurrence of the Project Office before they can be awarded.

Where DSS initiates audits of contractors through the Defense Contract Audit Agency in the U.S., there could be up to a three year delay resulting from that Agency's work backlog. The Crown is still in a position to recover overpayments through various means. Audits of major Crown projects commence immediately sufficient time has elapsed to permit meaningful results. For example, the audit of the TRUMP project started less than one year after the signing of the contract. DSS will continue to ensure that all necessary audits are carried out in a timely manner.

Insofar as industrial benefit contract requirements are concerned, the Department, in conjunction with the Department of Regional Industrial Expansion, will continue to enforce them.

DEPARTMENT OF NATIONAL REVENUE-TAXATION
TAX COLLECTION

DEPARTMENT OF NATIONAL REVENUE-TAXATION
TAX COLLECTION

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DEPARTMENT OF NATIONAL REVENUE-TAXATION TAX COLLECTION

Main Points

Productivity in tax collection declined by 18 percent over the past five years. A number of factors have made it more difficult to collect taxes and have had a substantial impact on productivity. In these circumstances, we examined management's efforts to operate within its environment. Subsequent to the audit, the Department responded that, according to 1987-88 figures, 1982-83 productivity levels have been restored. (paragraphs 17.7 to 17.9)

Over the last few years, management has stressed the importance of tax collection. In its continuing efforts to emphasize collection, the Department should improve its central support to managers and supervisors; broaden and refine its criteria for ranking accounts; strengthen supervisory control; and increase comprehensive monitoring of the activity. (17.16 to 17.43)

The implementation of a major shift in assigning accounts was not adequately planned. There were some deficiencies in the planning of the development of an automated system for collection. In addition, there is no comprehensive financial budget or cost accounting for this system development project. (17.52 to 17.69)

The Department has exercised reasonable efforts to collect the refundable tax on Scientific Research Tax Credits. Nevertheless, potential losses from the program are estimated at $1.2 billion. (17.82 to 17.91)

The Department's reporting of information on the collections activity in its Part III of the Estimates needs to be improved. For example, the Department did not report the outstanding balance of approximately $3 billion in refundable taxes on Scientific Research Tax Credits requiring settlement in cash payment or legal offset. The reporting of these taxes is also absent from the Public Accounts. (17.93 to 17.106)

DEPARTMENT OF NATIONAL REVENUE-TAXATION
TAX COLLECTION

Overview

17.1 Tax collection plays a significant role in revenue raising. The assessing and audit activities establish the tax liability owing to the Crown; the collection and cashiering functions provide the cash flow to meet the financial requirements of various government programs.

17.2 The collections function is one of five program activities of the Department of National Revenue-Taxation. In 1986-87, it operated with about 1,800 person-years and a $65 million budget, which represents about nine percent of the Department's resources. Its role is to collect taxes that are overdue. In 1986-87, such taxes receivable at the end of the fiscal year amounted to $3.3 billion (Exhibit 17.1).

17.3 The administration of collections is shared between head office and regional and district offices. The head office determines policy and procedures, provides direction and technical advice to district offices, and monitors compliance by collection officers. Its responsibilities also include budgeting, resource allocation and goal setting. Actions by collection staff are generally taken at the 36 district offices, which report to five regional assistant deputy ministers.

17.4 The tax collection process starts when taxes are assessed but not remitted and ends when the delinquent accounts are collected or written off. Annual inflow of new delinquent accounts plus accounts receivable at the beginning of the fiscal year make up the current year's workload. Production comprises all collection actions on accounts, including cash collection, write-offs and other sundry work disposal measures. All accounts requiring further work become part of the receivable balance at the end of the fiscal year.

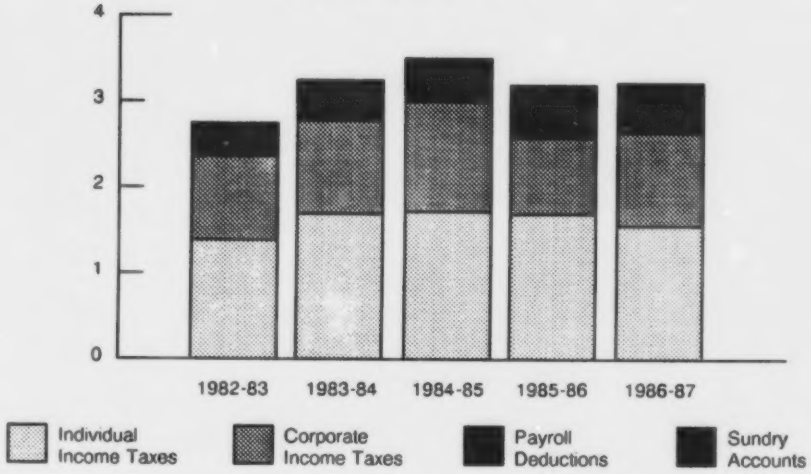
17.5 Initial action on delinquent accounts usually takes the form of computer notices generated by the central system reminding taxpayers of their debt and requesting payment. If the accounts remain unpaid, they are referred to district offices for further action.

17.6 At the district offices, collections staff attempt to contact delinquent taxpayers before taking any legal action. The officers try to collect the delinquent accounts in full and, failing that, they work out acceptable schedules for payment with the taxpayers. As a last resort, the Department uses its authority to garnishee wages, bank deposits and other income, or to seize and sell a taxpayer's assets to cover the amount owing.

17.7 Over the past five years, through increased resourcing and internal adjustments, person-years in the collections function have increased – from 1,100 in 1982-83 to 1,800 in 1986-87 (Exhibit 17.2). During the same period, productivity has declined. After adjusting

Exhibit 17.1

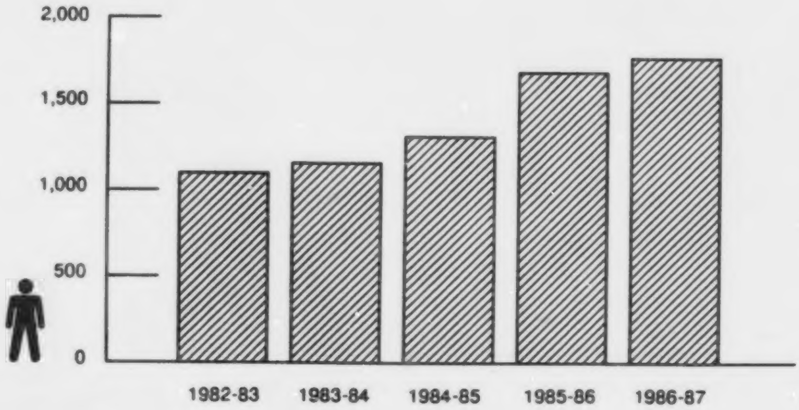
TAXES RECEIVABLE BY REVENUE TYPE
(in billions of dollars)



Source: Public Accounts of Canada and Department of National Revenue-Taxation's Annual Report

Exhibit 17.2

PERSON-YEARS USED IN TAX COLLECTION



Source: Department of National Revenue-Taxation's Estimates Part III for a change in the treatment of downward tax assessments, the production rate expressed in dollars per labour hour decreased by 18 percent (Exhibit 17.3). If the activity had maintained earlier rates of production, collection in 1986-87 would have been up by about $500 million. Subsequent to the audit, the Department responded that the 1982-83 productivity levels have been restored, according to 1987-88 figures.

17.8 In addition, the volume of write-offs reported in the Public Accounts has increased substantially. In 1986-87, the Department reported accounts written off totalling $600 million, up from $50 million in 1982-83. The preliminary figures for 1987-88 showed that the rising trend of write-offs appears to have halted. The reported balance of write-offs over the last five years is shown in Exhibit 17.4.

17.9 The Department attributes the decline in productivity and the increase in write-offs to a number of factors. It followed ministerial direction in 1984-85 to give increased attention to taxpayers' rights by taking a more careful and time-consuming approach, which included direct contact with taxpayers prior to any collection action. Also, the economic downturn led to a much higher volume of new delinquent accounts than the Department had anticipated. The addition of more than 300 person-years in 1985 to deal with these requirements resulted in a need for more supervision, training and development. In addition, the changing legislative environment required the Department to make administrative changes that had an adverse effect on productivity.

17.10 Over the last few years, management has stressed the importance of tax collection, including requesting additional resources; changing the method of assigning accounts to collectors; developing an automated system for collection; and focussing on clearing old accounts existing in the inventory.

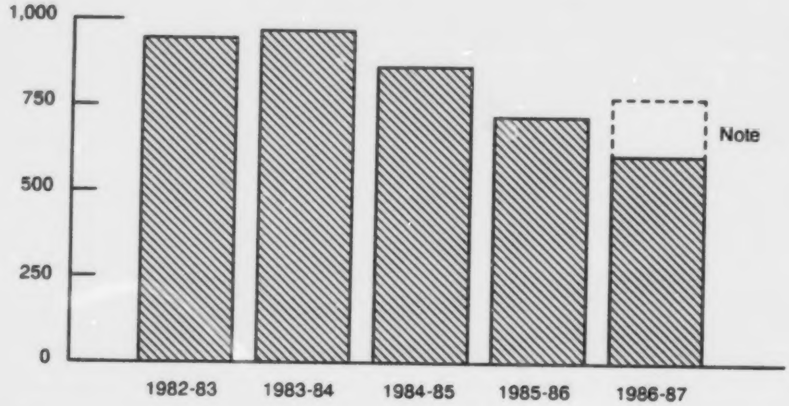
Audit Scope and Approach

17.11 Given that there are a number of factors that have made it more difficult to collect taxes and have had a substantial effect on the Department's operations, we examined management's efforts to operate within this environment. In our audit, we examined various aspects of tax collection management, including:

- the collection process, which includes assigning accounts to the collection staff, collecting the accounts, and supervising and monitoring collection actions;
- the write-off process and its controls;
- major changes in operations, including the change in assigning accounts to various levels of collection officers, and the new computer system now under development; and

Exhibit 17.3

PRODUCTION RATE IN DOLLARS PER LABOUR HOUR

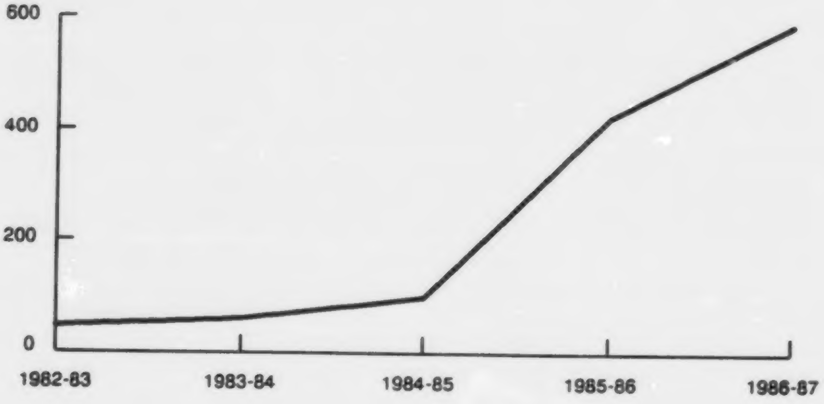


Source: Departmental records

Note: Downward assessments of tax were treated as part of production prior to late 1985. The dotted line indicates the level of production that would have resulted if downward assessments were included in 1986-87. For 1985-86, statistics on downward assessments are not available.

Exhibit 17.4

TAXES WRITTEN OFF
(in millions of dollars)



Source: Public Accounts of Canada

- information support systems, which consist of centralized information reporting generated by the computer system at head office, and information statistics maintained by local district office management.

17.12 In addition to looking at tax collection management, we considered areas of concern in the tax collection environment, which encompasses the income tax system and relationships with taxpayers. One issue that spanned management and environment was the collection of the refundable tax on Scientific Research Tax Credits (SRTCs), a program introduced in 1983 which carries potential program costs in revenue reduction of over $3 billion.

17.13 We also reviewed the reporting to Parliament on collections activity through the Public Accounts, the Department's Annual Report and Part III of the Estimates.

17.14 Our audit included an examination of selected reports and documents. We interviewed departmental staff at head office, and some regional and district offices. We also reviewed a number of active collection files and accounts that had been written off. In addition, we interviewed representatives from the private sector, including collection agencies.

Management of the Collection Process

17.15 We examined three aspects of the management of the collections activity - workload management, control over the collection process and account write-offs.

Workload Management

17.16 In support of the Department's program objective, Part III of the Estimates states that the objective of the collections activity is to collect billed taxes. It also states that the current policy is to prevent the inventory of accounts receivable from increasing by collecting each year at least the dollar equivalent of the new delinquent accounts and reducing existing inventory. For 1985-86 and 1986-87, management has set a target of maintaining the level of accounts receivable below $3 billion.

17.17 Although the Department has managed to reduce inventory, it has not been able to achieve the target level of receivables in these years. Because of the difficulty of accurately predicting the inflow of new delinquent accounts, the actual volume differs from the planned. In addition, productivity has fallen short of expectations that were based on historical performance. Moreover, management indicated that they have under-estimated the volume of accounts in dispute.

17.18 Unlike the situation in the private sector, a taxpayer does not have to apply for credit to owe tax. The volume of new delinquent accounts is primarily dependent upon taxpayers' behaviour, which is affected by economic conditions. Since the Department cannot limit the inflow of accounts, significant variances between actual and planned volume of workload can occur.

17.19 When this happens, regional and local management attempt to redeploy resources from other activities to tax collection. Although there is periodic reporting of new unpaid assessments and various collection statistics, the reports are not timely and the data is too voluminous and cumbersome to be of assistance to district offices in planning and managing their collection workloads. The system does not use information on tax assessments to anticipate when the actual inflow of accounts is going to vary significantly from planned inflow for district offices. Head office also does not update its program activity goal and advise the district offices of more realistic targets.

17.20 Collection resources are allocated annually on the basis of estimated volume of accounts and average time to collect. However, on an ongoing basis, the central system does not measure the actual active inventory level against individual operating capacity to identify situations where they vary significantly at the individual or aggregate level. This information would complement the resource allocation process and provide advance warning to assist management in managing the workload.

17.21 We found that departmental directives and procedures provide limited guidelines to assist local management and collectors to decide the order in which accounts ought to be acted on. The central system does not rank accounts for collectors in accordance with departmental direction for maximizing payback. Management relies on training and supervision to ensure that collectors work on accounts in the order which complies with this direction.

17.22 The Department is currently developing an automated system for the collections activity. The system under development includes a module to assess the risk of the accounts on the basis of their dollar value, age, source and type of tax assessment and revenue. When it is fully implemented, large, complex accounts that have been outstanding for long periods of time will have the highest priority.

17.23 While these criteria are undoubtedly important factors in setting priorities, other factors could have a substantial effect on recovery. The potential for cash collection of an account could form a factor in establishing the risk profile, for example. This may include information on past payment behaviour of the taxpayer and known sources of income or other assets. Also, the planned risk profile evaluation would not identify accounts that require immediate attention. For accounts of the same size and complexity, the evaluation would not determine those which might be in jeopardy if they were not handled on a timely basis. After the automated system is in place, it would be appropriate for the Department to assess and refine the risk profiling model.

17.24 **The Department should improve its central support to assist district offices to plan and manage their workloads. In addition, the Department should assess the effectiveness of its risk profiling model, with a view to broadening and refining the criteria used to rank accounts for collection, to provide for the best overall recovery.**

Departmental response: *We support the recommendations.*

Control over the Collection Process

17.25 We examined management's control over the collection process in four areas:

- policy and procedure guidelines;
- objectives and performance measurement;
- supervisory review; and
- head office and regional monitoring.

17.26 **Policy and procedure guidelines.** We reviewed the relevant sections of policy and procedure manuals and directives. In general, guidance is provided to the staff to take specific collection actions in various circumstances. Although the procedure manuals are not up to date and the staff has to refer to various information sources for direction, the Department recognizes this and is taking an initiative to update the manuals in 1988.

17.27 However, we noted that there was limited emphasis in the policy and procedure manuals on the expected elapsed time between various collection actions. An anticipated timeframe would support management's intention to stress timeliness of collection action. It would also provide guidance to collectors in pursuing timely actions and ensure more consistent application of such actions. For example, a general requirement to follow up on certain types of accounts within a specified time period would improve the consistency of follow-up actions. Moreover, this timeframe could become a control point for supervisory review. If the collectors fail to act within the timeframe, supervisors could become involved and provide assistance as necessary.

17.28 **Objectives and performance measurement.** The notion of using any quantitative basis for performance measurement is a sensitive issue in the Department. In 1984, the Department came under political pressure to disregard quantity of production when measuring performance. In November 1984, the Deputy Minister issued a memorandum to supervisors in taxation centres and district offices. In addressing the subject of setting performance goals, the enclosure noted:

> Quantity of anticipated production is not a factor when setting goals. Thus there should not be any references to an anticipated number of files to be completed, number of enquiries per hour to be done, number of dollars to be collected, number of leads to be generated, etc.

However, in the same communication, the Deputy Minister further stated that "the goals are based on the quality of the work expected and the timeframes anticipated to do it".

17.29 In the 1985 Woods Gordon study commissioned by the Minister of National Revenue, the Department stated its plan to balance quality, quantity and timeliness of work in the performance reviews of collection officers. At present, performance reviews are primarily based on the quality of the work done. Timeliness is considered implicit when assessing quality, but the quantitative measure of work performed has been eliminated.

17.30 As a result, production targets and objectives are set for district offices but are not identified at the collector level. With no quantitative work standards, individual collection officers are not held accountable for production results. In keeping with this philosophy, the central system does not facilitate monitoring of production statistics for individual collectors or their supervisors.

17.31 Objectives and quantitative measures are an important means of communicating management's expectations to operational staff. The Department informed us that it disagrees with the use of quantitative measures of individual production and that the ensuing risks of overly aggressive actions are considered unacceptable. In our opinion, the setting of individual workloads and targets in the collections activity should not mean that the collectors will engage in overly aggressive actions, and the lack of such measures does not guarantee the absence of abuses. Potential abuses could be minimized through training, policy and procedural guidance and close supervision. In addition, the use of such measures would provide guidance to supervisors in their planning and review of tax collection efforts.

17.32 **Supervisory review.** We found that the directions on supervisory review of collection activities are not specific. Although supervisors are expected to do spot checks and work reviews, there is limited guidance on the extent and nature of their review. Direct supervision at district offices is generally reactive, with supervisors responding to cases brought to their attention by the staff. A new directive requiring mandatory review of accounts meeting certain criteria was introduced in the fall of 1987. The primary focus of this review is on ensuring that the account has been assigned to the appropriate level of collection staff. However, it does not provide specific guidelines for ongoing supervisory review of collection actions.

17.33 In addition, the central system does not provide timely or adequate information for the supervisors. All district offices that we visited had to prepare management statistics locally to monitor results against production targets set for the office. The existing system also does not facilitate supervisory review of accounts. For instance, it does not highlight unusual situations for the supervisors to follow up, such as the failure of collectors to act on action dates previously identified. An account would be reviewed only if the supervisor decides to conduct a spot check and happens to select that file from a collector's inventory.

17.34 During our district office visits, we reviewed a number of accounts under collection action. Some files revealed that periods of months had passed without action or explanation. Some showed no evidence of any supervisory review. The level of review by supervisors varied between district offices.

17.35 A 1987 internal audit report noted that the head office functional group had frequently commented on the poor quality of work, caused mainly, in their opinion, by the lack of sufficient involvement by supervisory staff.

17.36 Effective supervision is an essential element of management's control over the collection process. It helps to assure management that the collectors achieve the desired productivity level and that proper procedures are applied fairly and consistently. It is particularly important in the collections activity where there are no quantitative work standards for the collection staff.

17.37 In addition to its emphasis on supervisory control, management needs to strengthen its requirement for supervisory review over the collection process at district offices. This, together with better information and support systems, would contribute to an effective supervisory structure for the activity.

17.38 **Head office and regional monitoring.** The head office functional group and the regional offices share the responsibility for overseeing the collections activity, including quality assurance and compliance with policy and procedures. Co-ordinating with regional offices, the functional group conducts monitoring reviews to discharge this responsibility.

17.39 We found that head office monitoring was infrequent. In the Woods Gordon report, it was noted that only three district offices were subject to full functional audits in 1983-84, and in recent years reviews have been completed for about ten offices. As a result, a large number of district offices have not had a full review by head office in the last five years. We were advised by the Department that comprehensive monitoring was suspended in the fall of 1986 to permit post-audits of write-offs.

17.40 Most regional offices have conducted a number of reviews in the past two years. However, one major region has only conducted minimal reviews during this time.

17.41 Periodic monitoring by head office and regional offices would provide some assurance to management on the appropriateness of collection actions carried out by the staff. The independent check would detect indications of non-compliance with departmental policy and procedures, inconsistent treatment of taxpayers, or undue delay in actions. In addition, we noted that the Department does not require the maintaining of statistics on the volume and nature of complaints from taxpayers regarding tax collection. Such data could be used to identify areas of concern in the activity.

17.42 In our opinion, management's control over the collection process needs to be improved. Productivity measures and objectives are used in many organizations to assist management in determining and communicating its expectations and to guide employees and help improve productivity. When they are not used, clear directions, close supervision and periodic monitoring become more essential to ensure effective management control.

17.43 **The Department should review and strengthen supervisory controls, provide guidelines and continue to emphasize timeliness of work, improve information support systems for supervisors and managers, and increase the conduct of comprehensive monitoring to improve its control over the collection process.**

> ***Departmental response:*** *We agree with the recommendation in general. However, we are of the opinion that the Department emphasizes supervisory controls and such controls should continue to be emphasized.*

Account Write-offs

17.44 We examined the process for writing off accounts and the control over such write-offs. We reviewed head office reports on post-audit of accounts written off and followed up on a number of these accounts.

17.45 We found the criteria for identifying an uncollectible account to be reasonable and commensurate with debt write-off regulations prescribed by Treasury Board. The responsibilities for identifying and approving write-offs are clearly defined and communicated.

17.46 In general, we found the control procedures over accounts written off under the Financial Administration Act to be adequate. Our examination of the post-audit reports and our file review led us to conclude that accounts were written off in accordance with the write-off criteria. The files examined also contained adequate documentation on collection actions taken prior to the write-off.

17.47 However, we noted that departmental records of write-off were not readily reconcilable with amounts reported in the Public Accounts. Write-offs of larger accounts, which require Treasury Board approval, were recorded and credited to the receivable balance before they were approved by the Board. Consequently, at the end of the fiscal year, the accounts that remained to be approved were not reported either as receivables or as write-offs. The backlog, finally approved and reported in 1985-86, totalled $157 million from 1980-81 to 1984-85. The Department is in agreement with our observation and agrees not to adjust the book balance until the submissions have been approved.

17.48 The Department's records of accounts written off consist of voluminous forms which provide information to support the write-offs. Summary reports of write-offs are only available in three forms – by revenue type, district office or write-off criteria. Except for some listings that identify accounts requiring Treasury Board approval, there is no detailing of accounts written off in any one fiscal year.

17.49 The lack of a readily accessible database on write-offs makes it more difficult to conduct data analysis for future planning and operation. For instance, information on the industrial sector to which corporate accounts belong or the primary sources of income of individuals could assist in refining the risk profile evaluation model. The aging of accounts and the breakdown between tax, interest and other charges in account balances are examples of other information which could assist to identify areas of potential improvement in the collection operation. With its computer facilities and existing data files, the Department could readily retain basic write-off data in a format that facilitates access.

17.50 **The Department should ensure that its accounting records of write-offs reconcile directly with amounts reported in the Public Accounts. It should also improve its ability to access write-off data.**

Departmental response: *We agree with the recommendations.*

Major Changes in the Collection Operation

17.51 There have been some major changes in the operation of the collections activity in recent years. In 1987, the Department implemented a workflow change which altered the assignment of accounts. It is also developing a computerized system to facilitate the collection process. We examined the implementation of the workflow change and the planning and development of the new computer system.

Workflow Change

17.52 Management commissioned an internal task force to review and recommend changes to the collection process. Its objective was twofold – to ensure appropriate matching of actual job tasks with the job descriptions for the classification levels of collectors, and to improve the efficiency of handling delinquent accounts.

17.53 In June 1986, the internal task force recommended changes to the classification structure of collection staff and the method of assigning accounts to collectors. The recommendations were adopted in 1987. In a directive dated 23 July 1987, head office announced the changes with an effective date of 1 September 1987. It provided directions on the new method of assigning accounts and announced that first level collection clerks would be upgraded to junior program officers.

17.54 The short lead time made it difficult for the district offices to comply by the effective date. Within five weeks, the district offices were required to set up the workflow according to the directive. In addition to handling new accounts, the offices had to reassign existing inventory to the level of collectors in the manner specified by the directive.

17.55 Under the new workflow method, most incoming accounts were to be reviewed by the first level junior collectors to determine their degree of complexity. Complex accounts were to be assigned to senior collectors subject to concurrence from the supervisors. However, the directive did not give specific guidance on identifying complex accounts. Moreover, there was only minimal support and training from head office at the time of implementation. Because of the short lead time, district offices could only supplement this with some local training.

17.56 The effective date for the change also coincided with the peak inflow of certain accounts. Individual taxpayers are required to file their tax returns by 30 April. Every fall, the inflow of new delinquent individual tax accounts to district offices peaks. Effecting the change during the peak inflow of accounts in September made it more difficult to comply with the new process of allocating accounts by the effective date.

17.57 The situation was further complicated by the decision to implement the new workflow before obtaining formal approval for the reclassification of the collection clerks. While the proposal to upgrade them to program officers was discussed with Treasury Board officials, six months after the July directive the Board proposed that they be classified at a different clerical level. This created delays and other problems in staffing in offices that needed additional junior collectors. The uncertainty also affected the morale of collectors who were part of the 600 to 700 person-years affected by this reclassification. Treasury Board finally approved the reclassification in March 1988, eight months after the directive.

17.58 We found the planning for the implementation of the workflow change to be inadequate. There should have been an implementation plan that identified the changes and actions required of the district offices and the length of time needed to carry them out. It should also have identified training needs and determined if on-site assistance by head office would be appropriate.

17.59 The change has had a major effect on the collection operation, affecting the way accounts are assigned and the staffing. Since the change is intended to improve collection, it is important for management to gain assurance that the new workflow and organization are more productive. While it may be too early to conduct a review, management could identify and start maintaining data and indicators that might be required for this purpose. We have not noted any plan on the part of the Department to evaluate the workflow change.

17.60 **The Department should emphasize planning when implementing a major change and conduct a post-implementation review of the change.**

> ***Departmental response:*** *We agree that planning of major changes and post-implementation reviews must be emphasized.*

Automated Collections System

17.61 The Automated Collections System (ACS) is a current initiative to increase the efficiency of the collection process through automation. It is intended to reduce paper burden, assign accounts by risk, expedite account transfers and the preparation of documents, and facilitate follow-up and review.

17.62 The initiative was first identified in 1985 through a department-wide study on Converging Technology. A feasibility study for the system was prepared in June 1986 and the first functional specifications were issued in February 1987. Project leaders from the systems group and the functional group joined the development team in July 1986 and March 1987 respectively.

17.63 The development team scheduled testing of the prototype system for April 1988. The implementation at the pilot site was to take place in July, to be followed by other offices starting in November. Nation-wide implementation of individual and corporate tax accounts is scheduled to be completed by 1990, and payroll deduction accounts are to be converted by 1991.

17.64 The development of ACS did not follow the Treasury Board Administrative Policy Manual, which sets out standard procedures for management and control in the development of computer systems. The direction to automate was given by senior management. However, problems to be resolved and user needs were not clearly defined and documented up front. The objectives of the system were refined only during the system design phase.

17.65 We noted that the ACS system essentially serves to automate the existing manual process, reduce paper burden and facilitate certain collection activities. Although the deficiencies in reporting by the central system are generally recognized, ACS, as designed, would not replace this system or reduce the need to reconcile with its reports. Moreover, the summary statistics required of the system are yet to be determined and will have to be incorporated at a later stage. Within the Department, there are also concerns about backup for the new computer system and contingency planning which remain to be resolved.

17.66 Furthermore, the feasibility study was not complete. The anticipated benefits arising from the implementation of the development project were not quantified. There was no estimation of productivity gains or potential cost savings in the feasibility study. There was also a lack of full costing of project development, implementation, operation and maintenance. Consequently, there was no effective cost-benefit analysis to justify the initiative.

17.67 There was no formal approval of the decision to develop the system with in-house resources. The project team identified several options but there was no evaluation on file showing the basis for dismissing them as alternatives. The reviews of the various options were carried out by separate units with no predetermined selection and evaluation criteria. The project team had not established that it would not be feasible or effective to modify systems identified as options or that it would have been more costly to do so.

17.68 As well, there is no comprehensive financial budget for the development project. The project team does not record the actual costs incurred. Although the project team operates under the direction of a steering committee, the finance and internal audit groups of the Department are not involved. The involvement of these groups would assist project costing, financial management and control and help to ensure adequate safeguards over the collection system.

17.69 **The Department should comply with Treasury Board guidelines in developing new computer systems and exercise proper control to ensure that systems are developed at the least cost to achieve their objectives.**

> ***Departmental response:*** *We agree that the Department should comply with Treasury Board guidelines and should exercise controls to ensure least cost development.*

Tax Collection Environment

17.70 The Department is empowered to take collection actions against delinquent taxpayers. Sometimes, strong legal actions are involved. The political and social environment requires that taxpayers' rights be respected at all times. In the collections activity, it is necessary to maintain the balance between using firm collection actions and respecting taxpayers' rights.

17.71 The income tax system relies on voluntary compliance and self-assessment. Widespread public acceptance of the need for tax compliance and enforcement is fundamental to a system such as ours. It is necessary that taxpayers view the enforcement of the tax system as fair, equitable and consistent. Public confidence in the system makes tax evasion and non-payment of taxes socially unacceptable. The application of firm but fair enforcement actions against delinquent taxpayers should then receive public support.

17.72 Communications and publicity foster tax compliance and build public support. In order to comply, taxpayers need to understand their rights and obligations. Within the context of the collections activity, taxpayers must know what information and remittances are expected of them and when. Due to the complexity of the Income Tax Act, it is incumbent upon the Department to provide assistance to taxpayers.

17.73 Taxes receivable amount to less than five percent of total tax revenue. Except for cases under appeal, the accounts represent tax liabilities that have been established and agreed to. However, taxpayers' failure to remit imposes significant costs on tax administration. In addition, write-offs also result in revenue loss to the Crown. These costs are ultimately borne by those taxpayers who comply and pay their fair share of taxes. These costs can be reduced by firm but fair collection actions.

17.74 In the past few years, the Department has undertaken a number of initiatives to improve information provided to taxpayers. With tax reform and ongoing legislative changes, the Department has a continuing role of communicating with taxpayers. The Department also periodically evaluates general support from the public and considers the need for publicity to strengthen this support.

17.75 The Department is responsible for tax administration. The responsibility for formulating tax policy and legislation rests with the Department of Finance. In the course of its administration, the Department brings technical deficiencies and cases of tax abuse to the attention of policy makers so legislation can be amended. From time to time, the Department also proposes tax policy changes for consideration by the Department of Finance.

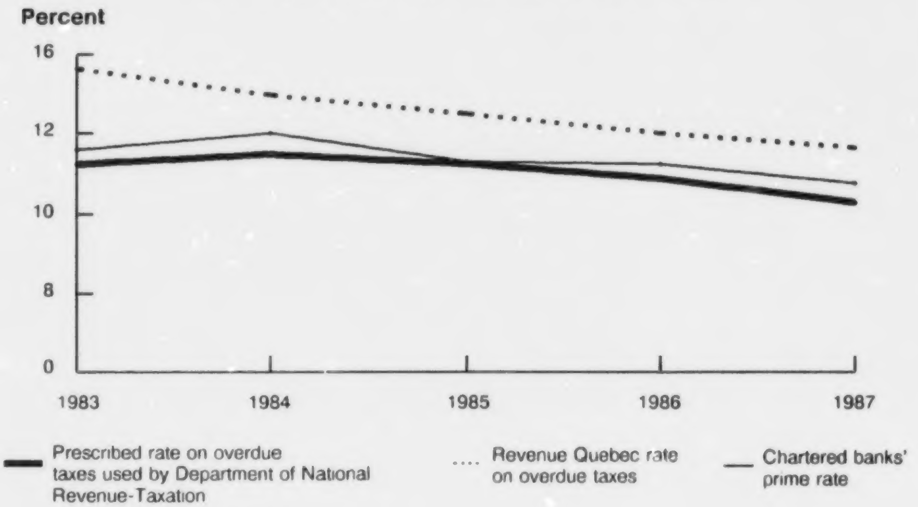
17.76 Over the past few years, the Department has undertaken some research projects with the objective of recommending policy changes to improve compliance and tax collection. It is important that the Department continue to emphasize research on new approaches to collecting taxes and, where appropriate, recommend legislative changes that will improve tax collection. We reviewed the method of prescribing the interest rate on unpaid taxes.

Interest on Unpaid Taxes

17.77 The Income Tax Act provides for the imposition of interest on late or deficient payment of taxes. Since January 1987, interest has been compounded on a daily basis. The rate of interest on underpayment of tax is prescribed by regulations under the Income Tax Act. It is determined on the basis of the weekly average yield of 90-day Treasury Bills and is

Exhibit 17.5

COMPARISON OF AVERAGE INTEREST RATES CHARGED ON OUTSTANDING ACCOUNTS



Source: - Departmental records
- Quebec Auditor General's Office
- Bank of Canada

updated every quarter. The prescribed rate reflects the short-term borrowing cost to the government. Under the Act, interest charges on unpaid taxes are not deductible for income tax purposes.

17.78 We compared the prescribed rate at the federal level to chartered banks' average prime rate and that of the Quebec Ministry of Revenue over the past five years. We noted that the federal rate was consistently lower than the other rates (Exhibit 17.5).

17.79 The relatively low rate, coupled with the fact that credit approval is not needed, makes owing tax more attractive than other forms of credit. While the non-deductibility of interest charges on unpaid tax may serve as a deterrent, there are some taxpayers who cannot deduct other types of interest charges. In these circumstances, the fact that the interest is not deductible loses its deterrent effect. Further, interest on unpaid Quebec tax is also non-deductible for tax purposes. Since it is set at a higher rate, Quebec taxpayers may pay their provincial tax before the federal tax. The federal rate could be made comparable with general lending rates so that it does not place the government at a disadvantage versus other creditors.

17.80 Financial institutions maintain a spread between borrowing and lending rates to cover operating costs and provide income. In the tax collection environment, it would be appropriate to have delinquent taxpayers pay for some portion of collection costs. The

Department could consider proposing the recovery of some portion of collection costs when prescribing the interest rate.

17.81 The Department should review the method of prescribing interest rates and recommend, if appropriate, the prescribing of interest rates that reflect market borrowing conditions and provide for the recovery of some portion of collection costs.

> ***Departmental response:*** *The question of interest rates is a policy matter which falls under the responsibility of the Minister of Finance. We agree that the method of prescribing interest rates be reviewed and proposals made, if appropriate, to prescribe rates that reflect market borrowing conditions and that provide for recovery of some portion of collection costs. The matter of interest rates has been reviewed and indeed modified on a number of previous occasions.*

Refundable Tax on Scientific Research Tax Credits

17.82 The Scientific Research Tax Credit (SRTC) program, which was introduced in the April 1983 federal budget, was enacted in January 1984 and made effective retroactively to 1 October 1983. It was intended to provide tax incentives to encourage companies to do research and development (R&D) and to facilitate their financing of R&D activities. Under the program a corporation issued shares, debt obligations or certain rights to investors. The investors would then receive a 50-percent tax credit on the investment, regardless of whether the corporation had performed any R&D. To ensure that the R&D was ultimately performed, the corporation became liable for a refundable tax which was equivalent to the tax credit. As the program was intended to provide tax incentives of immediate benefit to the R&D companies, legislation permitted investors to sell the investments immediately and realize quick, no-risk profits through what became known as "quick-flip" transactions.

17.83 Concern about the program rose almost immediately. On 10 October 1984, the Minister of Finance announced a moratorium on quick-flip transactions, limiting eligible investments to qualifying common equity shares with transitional rules for transactions entered into on or before that date. In the Budget Papers, the Department of Finance estimated the cost of the program, in revenue reduction, at $475 million over three years. In October 1984, before the announcement of the moratorium, the Department of National Revenue-Taxation recorded refundable taxes for the program of approximately $1.6 billion. In the May 1985 budget, when the Minister of Finance announced the termination of the SRTC program, potential program costs exceeded $2.8 billion; these rose to $3.5 billion by December 1987.

17.84 We reported our concern about the failure of the Department of Finance to safeguard public money in the SRTC program as an audit note in our 1984 Report. The Public Accounts Committee, reporting to the House of Commons, concluded that the Department of Finance was negligent in its management of the SRTC program.

17.85 In this audit, we reviewed the Department of National Revenue-Taxation's collection of the refundable tax. To further our understanding of its administration, we met with tax audit staff and examined some audit files. We have not assessed the Department's audit or other program activities in connection with SRTC.

17.86 Companies were required to file designations advising the Department that they had issued securities under the SRTC program. The designations were due at the end of the month following the month of the security issue. On recording the designations, the Department began monitoring actions. The purpose of the monitoring was to determine how the corporation intended to satisfy its tax liability and whether funding or financing arrangements were in place. Particular attention was paid to quick-flip transactions as companies tended not to have sufficient funds to finance the level of R&D activities required to offset the tax. In most cases, the monitoring was conducted jointly by audit and collection staff. Accordingly, the collection staff would undertake to collect, obtain security or defer collection action. The issuance of assessments started in July 1984; monitoring began in August 1984.

17.87 These accounts could take years to finalize. A major source of delay is the uncertainty about what constitutes a qualifying R&D expenditure. During 1985-86, the Department sought expert advice on this from the R&D community. Further delay was caused by the nature of the SRTC program, which permits funds to remain in a company to be expended on R&D. Collection action would only be taken when this was unlikely to occur.

17.88 The legislative provisions also placed the Department in a vulnerable position from the start. Assessment of refundable taxes owing could not be issued until the filing due date, which was up to two months after the securities were issued. In some cases, taxpayers could have redirected the funds before the start of the monitoring process.

17.89 The recovery of the tax on SRTC has been poor. At present, the Department is estimating potential write-offs at $1.2 billion. The Department's projection of qualifying expenditures and investments, cash recovery and write-offs as at 25 December 1987 is shown in Exhibit 17.6.

17.90 The responsibility for collecting SRTC receivables was assigned to specific district offices. In most of these offices, separate sections were set up to handle the accounts, which were recognized as high-priority items within the collections activity. We noted that the Department had assigned some of its most experienced officers to the SRTC collection. Our file review showed that contact with the taxpayers was generally made on a timely basis. In some cases, we noted frequent efforts by collection officers to query the status of their tax audits and the resulting assessments.

17.91 In view of the adverse circumstances, we concluded that the collections activity demonstrated reasonable efforts in attempting to collect amounts due under the SRTC program.

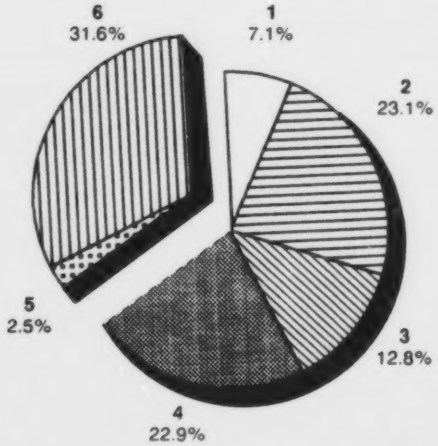
Information to Parliament

17.92 Information on the collections activity is reported to Parliament through the Public Accounts, the Department's Annual Report and Part III of the Estimates. The information in the Public Accounts follows a prescribed reporting format, and includes financial data on

Exhibit 17.6

REFUNDABLE TAX ON SCIENTIFIC RESEARCH TAX CREDITS AS OF 25 DECEMBER 1987

		$ millions
1	Cash & securities received to date	$247
2	Qualifying R&D expenditure to date	$814
3	Expected cash or qualifying R&D	$449
4	Qualifying investments	$806
5	Write-offs - actual to date	$88
6	Write-offs - potential	$1,113
		$3,517



Source: Departmental records

receivables and write-offs. The Annual Report provides financial data similar to that in the Public Accounts. The Department's Part III document contains a brief description of the collection activity, the resources it requires, some justification of the required resource level, and some statistical data on receivables and production.

SRTC Reporting

17.93 The documents prepared for Parliament's information made little mention of SRTC receivables. The 1986-87 Annual Report of the Department referred to SRTC receivables in the notes on the financial data on receivables. The 1986-87 Public Accounts and the 1987-88 Part III document failed to mention the SRTC receivables. Yet the outstanding balance for taxes under the SRTC program has been about $3 billion in the last two years. The amount was comparable to the level of regular taxes receivable.

17.94 The Department has not included SRTC receivables in the reported receivable balance because the collection of these accounts is doubtful and the taxes are refundable if the taxpayer performs eligible R&D activities. However, such information could be separately disclosed.

17.95 SRTC write-offs have been included in the reported balance of accounts written off, without reference to the portion attributable to them. Although the amount of such SRTC write-offs has not been significant to date, the Department expects to write off $280 million SRTC receivables in 1987-88.

17.96 We concluded that the reporting on the SRTC program is not adequate. Furthermore, it is inconsistent to report write-offs but not receivables under the program.

17.97 The Department should improve its reporting of the SRTC program in the Public Accounts and Part III of the Estimates.

> ***Departmental response:*** *We agree with the recommendation. The Department has already taken steps to effect improvement in the reporting of the SRTC program in the Public Accounts and Part III of the Estimates.*

Other Reporting Considerations

17.98 The study on Reporting to Parliament reported in Chapter 5 noted that Members of Parliament want information in the Part III documents that is understandable and readily accessible. In this review, we identified a number of examples where reporting in the Department's Part III document could be improved.

17.99 At present, the Part III document provides some comparative data on the collections activity in tabular form. Graphs or charts would better display the trends and facilitate the understanding of changes over the years.

17.100 The Part III document also contains technical terms that are not explained. A prime example is the use of "closing" of accounts in presenting selected performance data. A reader could construe this to be cash collected when, in fact, it includes other production measures such as write-offs. Further, the definition of what constitutes closing changed during 1985. This could cause the reader to misinterpret the trend of performance statistics. Explanation of collection terminology and highlighting or adjusting for changes in the definition would reduce the possibility of misunderstanding.

17.101 A great deal of information that is not at present in the Part III document but that would be useful to Members of Parliament is currently available in other documents or within the Department. To improve the reporting in the Part III document, the Department could add such information or make reference to where the information would be available. Examples of the type of information we have in mind are discussed in the paragraphs that follow.

17.102 We noted that the tax receivable balance is presented in total in Part III of the Estimates. A breakdown showing taxes owing from individuals and those owing from corporations, payroll deductions owing from employers, and other accounts receivable would provide more comprehensive information on the receivables.

17.103 The accounts receivable balance includes all accounts in dispute, but such information is not disclosed in the Part III document. The portions of the tax balance in dispute are not subject to immediate collection actions unless the danger of loss through delay can be proven. Further, tax assessments giving rise to these receivables could be reversed as a result of the appeal process. Specifying the amount of taxes in dispute would therefore provide a better context for understanding the overall receivable balance.

17.104 The Part III document also does not include any information on write-offs despite the escalation of their amounts in recent years as shown in Exhibit 17.4. This information, together with explanations for the increase, would be useful.

17.105 Information on the age of accounts comprising the receivable balance is also not reported in the document. The age of accounts provides a general indication of collection efforts required and the ultimate collectability of the accounts, and would help Members to understand the state of the receivables.

17.106 **The Department should improve its reporting of the collections program activity in Part III of the Estimates.**

> ***Departmental response:*** *We agree with the recommendation. The Department has already taken steps to effect improvement in reporting of the collections program activity in Part III of the Estimates.*

CANADA EMPLOYMENT AND IMMIGRATION COMMISSION
UNEMPLOYMENT INSURANCE ACCOUNT

CANADA EMPLOYMENT AND IMMIGRATION COMMISSION
UNEMPLOYMENT INSURANCE ACCOUNT

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18

CANADA EMPLOYMENT AND IMMIGRATION COMMISSION UNEMPLOYMENT INSURANCE ACCOUNT

Main Points

Since 1983, the Commission has improved its productivity in processing UI claims. Nevertheless, the variable unit costs of processing claims still varied by some 122 percent among all Canada Employment Centres (CECs) in 1987-88. Savings could result if the least productive CECs could lower their unit costs to the national average. (paragraphs 18.13 to 18.24)

Records of employment prepared by employers are a significant source of errors. The Commission estimates overpayments and underpayments due to such errors at $76 million and $57 million respectively in 1987. (18.41 to 18.43)

With the revitalization of CECs, the Commission introduced significant improvements in some of its employment service delivery mechanisms. Their effect on operational efficiency and effectiveness will not be known until performance indicators are selected and program evaluation results are available. (18.65 to 18.71)

There were significant differences in the application of the registration policy on worker-clients. Computerized inventories of worker-clients were not always used efficiently and effectively. (18.86 to 18.92)

Insufficient co-ordination and communication between Employment and Insurance Services hindered the prompt re-employment of UI claimants. Substantial savings could be achieved if greater efforts were made to help UI claimants return to the workforce more quickly. (18.96 to 18.106)

UI claimants who meet the Commission's criteria are not systematically registered with Employment Services. This renders the worker-client inventory incomplete and reduces CECs' access to potential suitable candidates. Most CECs visited did not have an effective system of controls for UI claimants who failed to report to an employer for a job interview. (18.102 to 18.110)

At 31 March 1988, the UI Account surplus of $1.7 billion reduced the annual deficit of Canada. It would be desirable to continue to maintain a reasonable surplus position as a preventive measure. (18.120, 18.121)

CANADA EMPLOYMENT AND IMMIGRATION COMMISSION UNEMPLOYMENT INSURANCE ACCOUNT

Introduction

18.1 Through the Employment and Immigration Reorganization Act of 1977, the former Department of Manpower and Immigration and the Unemployment Insurance Commission were amalgamated to form the Canada Employment and Immigration Commission (CEIC) and the Department of Employment and Immigration.

18.2 The Commission is responsible for all employment, unemployment insurance and immigration programs, while effective development and implementation of federal labour market and immigration policies are the responsibility of the Department.

18.3 The Commission administers the Unemployment Insurance Act, 1971. The Deputy Minister and Associate Deputy Minister of the Department of Employment and Immigration also fill the roles of Chairman and Vice-Chairman of the Commission respectively. The Executive of the Commission also includes two Commissioners, one representing workers and the other representing employers.

18.4 The Commission is highly decentralized, with some 460 Canada Employment Centres (CECs) providing employment and unemployment insurance services, 187 mobile service units and employment offices in 105 post-secondary institutions. National headquarters and a regional office in each province co-ordinate and support the activities of the CECs.

18.5 The financial operations of the Unemployment Insurance Account are included in the Accounts of Canada. Revenues flow into the Account from the premiums paid by employees and employers, and contributions by the government for its share in the payment of benefits. Expenses charged to the Account include the unemployment insurance benefits paid out, administration costs and interest. The revenues and expenses are shown in Exhibit 18.1.

Audit Scope

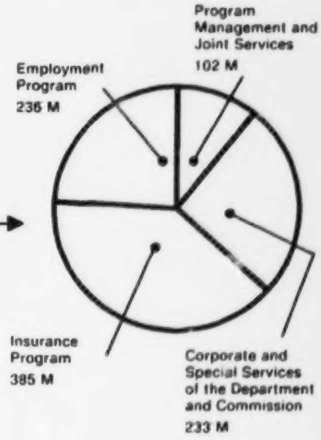
18.6 Our value-for-money audit of the Unemployment Insurance Account covers two fiscal years. This year's audit examined two significant sub-activities of Insurance and Employment: claims processing and labour exchange. The scope for our examination of program effectiveness procedures included all the program evaluations of the Unemployment Insurance Activity. In the coming year we intend to audit the operating costs of other significant Employment and Insurance sub-activities, as well as the general administrative expenses charged to the Account.

Exhibit 18.1

UNEMPLOYMENT INSURANCE ACCOUNT
FINANCIAL SUMMARY-1987

Revenue	Millions $
Premiums from employers and employees	10,246
Government contributions	2,817
Penalties	18
	13,081
Expenses	
Net benefits	10,317
Administration	956
Interest	270
Bad debts	13
	11,556
Surplus	1,525

Administration Costs



Source: Part III - Estimates

18.7 The main objective of the audit was to determine whether the two sub-activities selected had been managed with due regard for economy and efficiency, whether procedures were in place to measure and report on effectiveness, and whether all the relevant laws, regulations and directives had been complied with.

18.8 The audit covered 28 CECs, most of which were situated in urban areas in the six provinces visited (Ontario, Quebec, Alberta, British Columbia, New Brunswick and Newfoundland).

Unemployment Insurance Program

Introduction

18.9 Since its establishment in 1940, the Unemployment Insurance Program has become one of the most significant national programs. It affects most Canadians; more than 12 million workers contribute to the revenues of the Unemployment Insurance Account, as do their employers. Since 1981, UI benefits have gone to an average of more than 3 million people each year, and the number of claims reaches about 3.4 million a year.

18.10 Unemployment Insurance is a compulsory program providing temporary income protection for unemployed workers who are looking for work or who are unable to work because of illness, childbirth or adopting a child.

18.11 The forecasted operating costs of the unemployment insurance activity for 1987-88 were as follows:

	$ (000)	%	Person-years	%
Claims Processing	191,585	50	5,224	60
Reception and Enquiries	45,573	12	1,266	14
Benefits Payment	54,312	14	920	11
Insurance Control	34,982	9	918	11
Premium Collection	35,085	9	*	-
Program Management and Design	18,949	5	321	3
Other	4,960	1	105	1
Total	385,446	100	8,754	100

* Responsibility of Revenue Canada

18.12 The audit involved mainly the sub-activity concerned with claims processing. We examined the systems in place to manage operations and measure performance and the Commission's procedures for measuring and reporting on program effectiveness.

Claims Processing

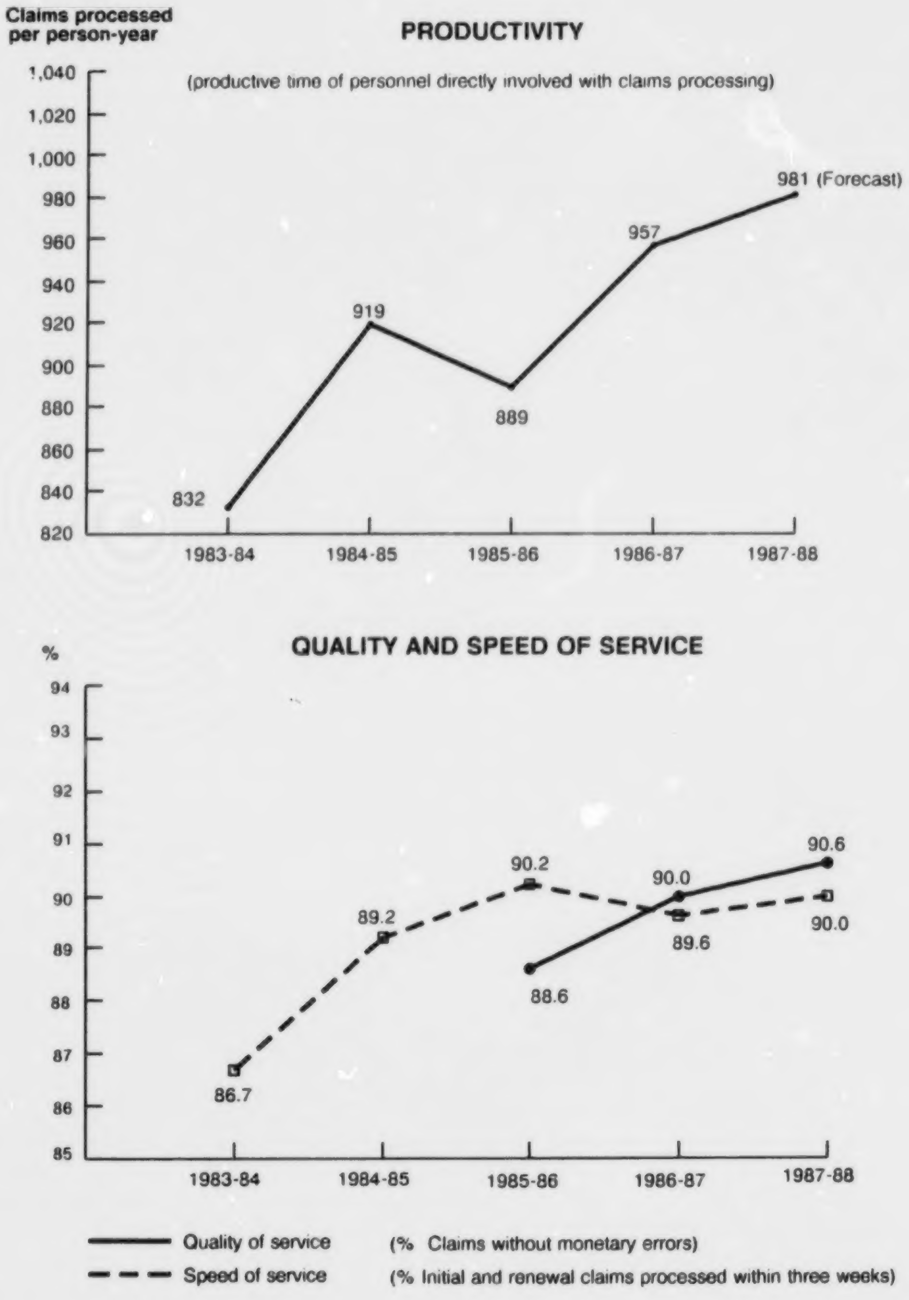
The Commission has improved its productivity in processing UI claims in the past five years. Nevertheless, important variations in variable unit costs of claims processing among Canada Employment Centres indicate the potential for further increases and financial benefits.

18.13 Claims processing includes all activities associated with the receipt and registration of claims for UI benefits, determining eligibility and the amount of benefits, and subsequent decisions about the rate and duration of benefits. These activities are carried out in some 276 Canada Employment Centres (CECs) in all provinces and territories.

18.14 Using Commission data, we compared the variable (direct) unit costs of processing claims among CECs. We also reviewed the operational practices of 13 CECs in 6 provinces to determine whether it is possible to increase productivity while maintaining a reasonable level of quality and speed of claims processing.

18.15 Productivity takes into account activities where the level of resources varies directly with the work involved in processing initial and renewal claims.

Exhibit 18.2



Source : CEIC reports

18.16 Since 1983-84, productivity in claims processing has risen by about 18 percent. This improvement took place at a time when claims processing was becoming more complex because of changes in the regulations governing the treatment of severance benefits and pension income (1985-86). In addition, the work involved in processing claims increased following introduction of a program of increased interview activity. According to the Commission's indicators, this improvement did not affect the quality or speed of the claims processing (see Exhibit 18.2).

18.17 Although improvements have been noted over the past five years, the variable unit costs of processing claims still varied by some 122 percent among all CECs in fiscal 1987-88 as follows.

Range of Variable Unit Costs of Claims Processing by CECs

Year	(1) Lowest	(2) Highest	(2-1) / (1) % Difference
1987-88	$ 21.10	$ 46.81	122%
1986-87	19.50	52.06	167%
1985-86	18.28	50.98	179%
1984-85	17.80	55.76	213%
1983-84	15.44	57.15	270%

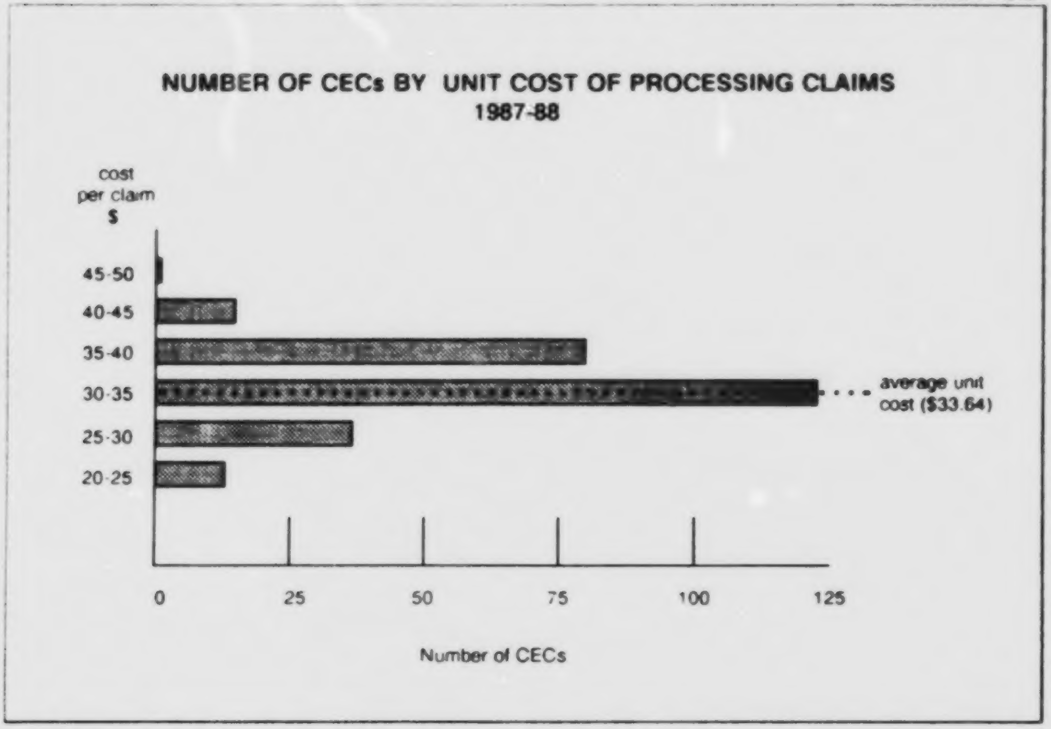
Our analysis, as shown in Exhibit 18.3, indicates that the average variable unit cost was $33.64 with the following distribution; 18 percent of the CECs were less than $30, 46 percent were between $30 and $35, while the remaining 36 percent were over $35. Nevertheless, the fact remains that, at these rates of productivity, it cost some CECs just over double the amount it cost others to accomplish essentially the same work.

18.18 There is always room to improve productivity; this is evident in the fact that there are important variations in unit costs of claims processing among the CECs. Because CECs carry out the same tasks and employ largely the same categories of people to process claims, important spreads in productivity or unit processing costs show that some CECs have discovered more economical and efficient ways of working.

18.19 Productivity in claims processing is affected by several factors. According to insurance program managers, the principal factors are management practices, the experience of the claims officer, peaks and valleys in the workload, the number of disputed claims, the completeness and reliability of information on which decisions about a claim are based, and the additional controls in place as a result of the increased interview activity.

18.20 Although we observed these factors at work in the CECs we visited, in only one of the six provinces had steps been taken to develop a resource allocation model that takes some of these factors into account. If the model had been applied to resources for 1988-89, the factors used would explain a variance in productivity of only 6 percent among CECs in the province, whereas the actual variance is about 65 percent. It is therefore evident that a large portion of the range in variable unit costs cannot be fully justified.

Exhibit 18.3



18.21 We believe that savings could be achieved through increased productivity at some CECs by improving management and operating practices, allocation of resources and by a more rational use of temporary help.

18.22 For example, we estimated that, if the least productive CECs could lower their unit costs of processing claims to the national average of $33.64, annual savings of about $4.5 million would be realized.

18.23 Some regions have begun to centralize claims processing where it is cost-beneficial to do so. Significant economies of scale are also possible when processing is concentrated in this way. The savings would be even larger where the decision-making process could be assisted by greater use of automation.

18.24 During the course of the audit, a Commission task force was reviewing various operating practices in use across the country to determine whether claims processing could be simplified. This study could identify sources of savings in this area.

18.25 **The Commission should accelerate implementation of measures to lower claims processing costs at some CECs and concentrate claims processing where it would be cost-beneficial to do so, while maintaining quality and speed.**

Commission's response: *The Commission is continuously reviewing productivity levels in CEC claims processing while striving to achieve a pattern of consistency in the Commission objectives of timeliness, accuracy and sensitivity in the operational delivery of service. A steady increase in productivity has been realized for a number of years as noted by the Auditor General. Further productivity increases are expected from the introduction of streamlined procedures and automation initiatives which are in progress. Although savings can be realized from concentrating claims processing or closing offices, service to the communities in question must also be considered.*

There will, however, always be variances in claims processing costs between CECs as the labour markets and communities served by the 276 CECs are different.

18.26 **Quality of claims processing**. Our 1983 Report (paragraphs 8.61 and 8.62) stated that the Commission's national headquarters did not have the information necessary to evaluate claims processing control functions or to identify the more common causes of errors leading to over- or underpayments; as a result, the Commission had difficulty taking appropriate corrective action.

18.27 Since 1984, the Commission has operated a Comprehensive Tracking System to estimate undetected over- and underpayments of unemployment insurance benefits and to provide quarterly information on the most common causes of errors.

18.28 Exhibit 18.4 shows the level of undetected over- and underpayments of benefits over the past four years as estimated by the Comprehensive Tracking System.

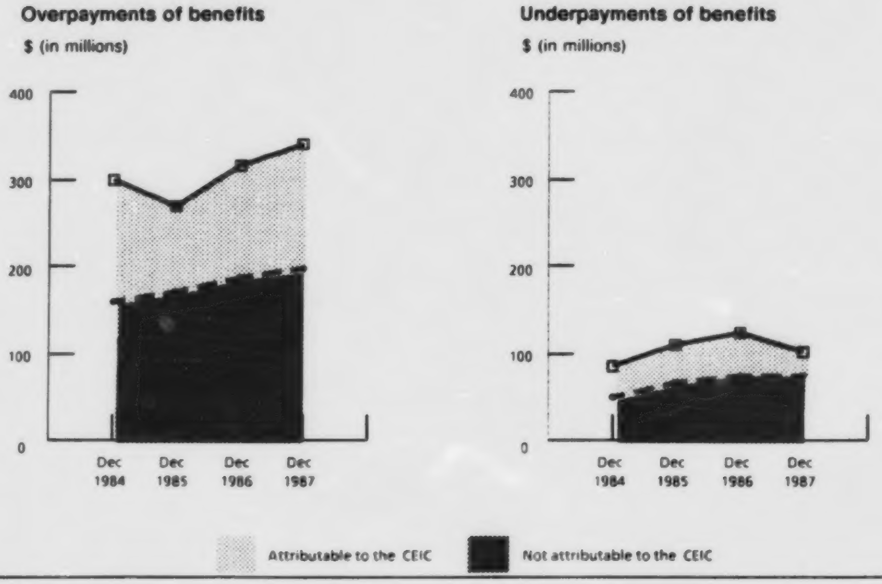
18.29 Errors attributable to the Commission have remained relatively stable since 1984 at approximately 1.4 percent of payment of benefits ($10 billion), even during a period of increased productivity described in paragraph 18.16. In 9 of the 13 CECs we visited, however, we found inadequate follow-up of discrepancies noted when the insurable weeks and earnings used to establish the rate and duration of benefits were not properly supported by the records of employment. This could result in incorrect payments of benefits or unreasonable delays in following up errors.

18.30 In April 1987, the Commission revised its methods of calculating benefit rates to simplify and standardize them. The possibility of further automating the decision-making process by introducing work stations for insurance agents is also being studied. According to the Commission, these efforts should help to reduce the number of errors attributable to the Commission. We did not review these initiatives because they were not yet in full operation at the time the audit took place.

18.31 **The Commission should improve its control to ensure that insurable weeks and earnings used to establish the rate and duration of benefits are properly supported and any discrepancies are followed up on a timely basis.**

Exhibit 18.4

UNEMPLOYMENT INSURANCE ACCOUNT
MOST LIKELY VALUE OF ERRORS IN THE PAYMENT OF BENEFITS



Commission's response: *The automated Support System for Agents is scheduled for implementation beginning in the 1989-90 fiscal year. It is anticipated that this system will materially reduce overpayments and underpayments attributable to calculation, transcription and other clerical errors now taking place in manual operations. Pending implementation of this system, the Commission will continue to rely on Quality Monitoring activity and the Comprehensive Tracking System as determinants of the extent of error and the Record of Employment Discrepancy Reporting System for detection.*

18.32 Salaries and wages not reported (or reported incorrectly) by claimants and undetected at the time of the claimant's file review by the Comprehensive Tracking System are the main cause of benefit overpayment errors not attributable to the Commission. This type of error has increased by 77 percent since 1984. In 1987-88, the Commission initiated administrative measures to reduce abuses.

18.33 **Performance measurement.** Claims processing operations are monitored using indicators of productivity, quality and speed of service. These indicators are used by managers to account for the activities for which they are responsible. In addition, engineered time standards have been developed for claims processing. However, these standards are not being used to measure efficiency; such measurement would permit objective comparisons and evaluation of results.

18.34 The Commission should make use of its engineered time standards to measure efficiency of operations.

> ***Commission's response:*** *The Commission maintains a range of operational performance standards designed to track productivity, speed and quality. These standards are based on historical data. The Commission utilizes engineered standards to assess resource impacts of new processes but finds their application too complex and costly in measuring daily operations. In future, the Commission will conduct efficiency studies, on a sample basis, using engineered standards.*

Administration of Records of Employment

Records of employment are a significant source of errors and result in additional costs in claims processing.

18.35 The record of employment (ROE), prepared by employers, is the basic document of the unemployment insurance system (see Exhibit 18.5). It provides information to the Commission with respect to salary or wages, the number of insurable weeks of work, and the reason for separation for an employee who has had an interruption of earnings. This information must be accurate, complete and timely for the economical determination of a claimant's eligibility, benefit rate and duration of payments.

18.36 The Commission uses some 190 person-years at an annual cost of $6 million to transmit and record ROE forms and to assist insurance officers in detecting errors. Our audit covered the following main points:

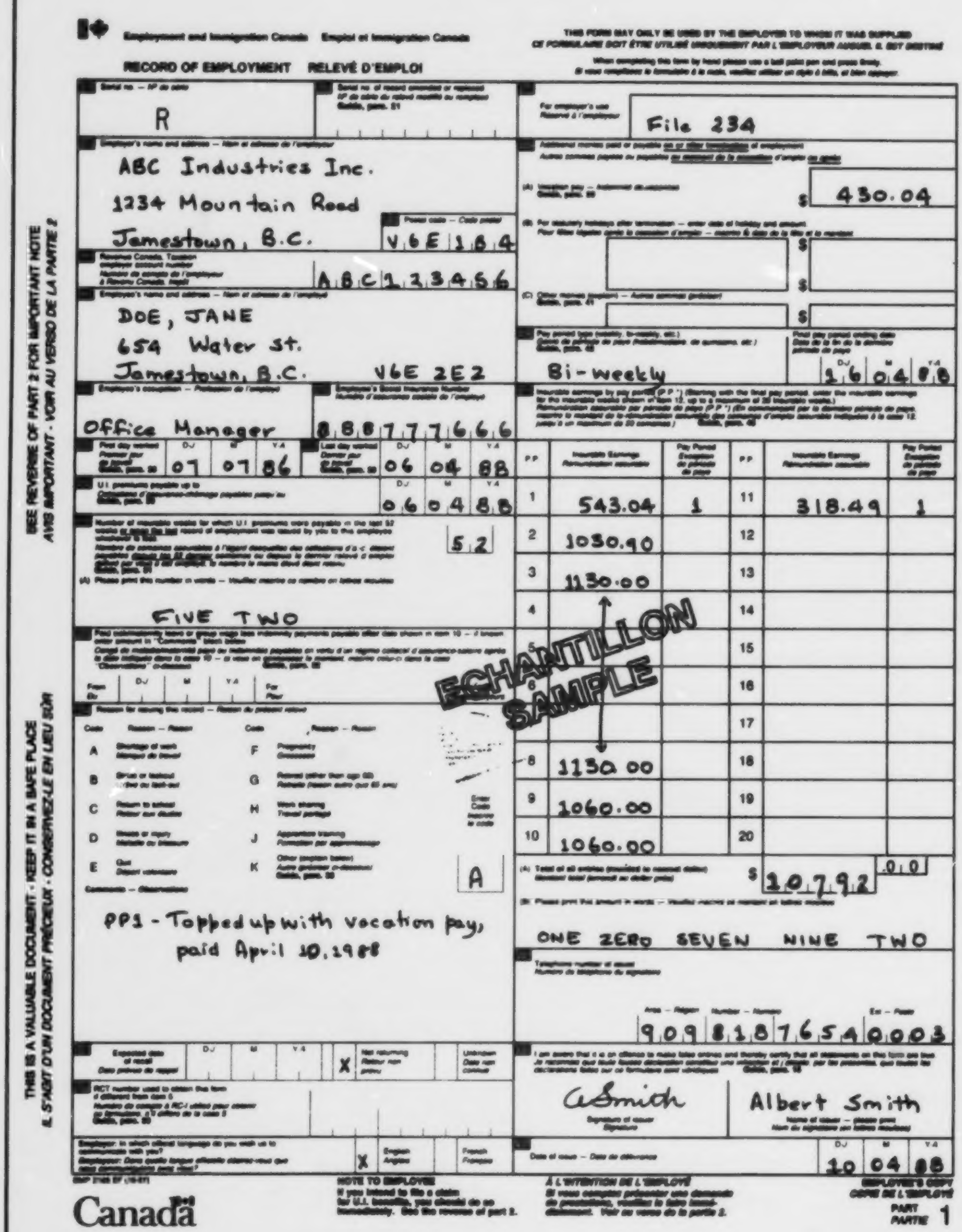
- the control of ROE forms;
- the use of ROE forms for decision making; and
- proposed administrative improvements.

18.37 **Control**. In 1987-88, claimants presented some four million ROEs to establish their claims for UI benefits. However, not all employers submit their ROEs within the prescribed time limit. Our sample of ROEs showed that 15 percent had been issued after the deadline prescribed in the regulations. These employers are contravening the Unemployment Insurance regulations governing the submission of ROEs. In addition, Commission data show that about five percent of ROEs, or some 200,000 forms, are never sent to the Commission by employers.

18.38 Failure to submit an ROE or submitting it late incurs extra costs for the Commission, and delays and errors in claims processing can also occur. The Commission is restricted under the existing legislation from establishing administrative penalties for those employers who fail to fulfil their obligation to provide the record of employment within five days of interruption of earnings. Their only recourse is through court action. Only in extreme

Exhibit 18.5

AN EXAMPLE OF A RECORD OF EMPLOYMENT COMPLETED BY EMPLOYERS



Employment and Immigration Canada Emploi et Immigration Canada

RECORD OF EMPLOYMENT RELEVÉ D'EMPLOI

SEE REVERSE OF PART 2 FOR IMPORTANT NOTE
AVIS IMPORTANT - VOIR AU VERSO DE LA PARTIE 2

THIS IS A VALUABLE DOCUMENT - KEEP IT IN A SAFE PLACE
IL S'AGIT D'UN DOCUMENT PRÉCIEUX - CONSERVEZ-LE EN LIEU SÛR

Serial no.: R

For employer's use: File 234

Employer's name and address:
ABC Industries Inc.
1234 Mountain Road
Jamestown, B.C.
Postal code: V6E 1B4

Employer account number: ABC123456

Employee's name and address:
DOE, JANE
654 Water St.
Jamestown, B.C. V6E 2E2

Employee's occupation: Office Manager

Employee's Social Insurance Number: 888777666

	DJ	M	YA
First day worked	07	07	86
Last day worked	06	04	88
U.I. premiums payable up to	06	04	88

Number of insurable weeks: 52

(A) FIVE TWO

Additional monies paid or payable on or after termination of employment:
(A) Vacation pay: $ 430.04

Pay period type: Bi-weekly

Final pay period ending date: 16 04 88

PP	Insurable Earnings	Pay Period Exemption	PP	Insurable Earnings	Pay Period Exemption
1	543.04	1	11	318.49	1
2	1030.90		12		
3	1130.00		13		
4			14		
5			15		
6			16		
7			17		
8	1130.00		18		
9	1060.00		19		
10	1060.00		20		

(A) Total of all entries: $ 10792 .00

(B) ONE ZERO SEVEN NINE TWO

ECHANTILLON SAMPLE

Reason for issuing this record — Raison du présent relevé

Code	Reason — Raison	Code	Reason — Raison
A	Shortage of work Manque de travail	F	Pregnancy Grossesse
B	Strike or lockout Grève ou lock-out	G	Retired (other than age 65) Retraite (raison autre que 65 ans)
C	Return to school Retour aux études	H	Work sharing Travail partagé
D	Illness or injury Maladie ou blessure	J	Apprentice training Formation par apprentissage
E	Quit Départ volontaire	K	Other (explain below) Autre (préciser ci-dessous)

Enter Code: A

Comments — Observations:
PP1 - Topped up with vocation pay, paid April 10, 1988

Expected date of recall: X Not returning

English / Anglais: X

Telephone number of issuer: 909 8187654 0003

Signature of issuer: a Smith

Name of issuer: Albert Smith

Date of issue: 10 04 88

NOTE TO EMPLOYEE:
If you intend to file a claim for U.I. benefits, you should do so immediately. See the reverse of part 2.

EMPLOYEE'S COPY
COPIE DE L'EMPLOYÉ
PART
PARTIE 1

Canada

SOURCE: CEIC

circumstances, where employers have allegedly failed to issue the claimant's record of employment, has the Commission made such prosecutions (approximately 100 cases in 1987-88).

18.39 We note that federal legislation provides other departments with the authority to impose administrative penalties in similar circumstances such as failure to submit on time payroll deductions at source (including premium remittances). Furthermore the Commission can impose administrative penalties on claimants who make false or misleading statements in relation to a claim for benefit.

18.40 The Commission should recommend an amendment to the UI legislation that would allow it to impose administrative penalties on employers who fail to provide records of employment within the prescribed time.

> ***Commission's response:*** *The Auditor General's comments have been noted and, if in the future, the U.I. legislation is re-examined, consideration will be given to this recommendation.*

18.41 Use of ROEs in decision making. Insurance agents rely on information on the ROE forms to determine eligibility, the benefit rate and the number of insurable weeks of work. When this information is inaccurate, errors can occur in calculating the amount of benefits, including the number of weeks of benefits for which the claimant is eligible.

18.42 Our sample of claims in the 13 CECs visited showed that, for 3 claims out of 5 (60 percent of claims examined), insurance agents had to follow up information on an ROE to verify its accuracy. This results in extra time and additional costs to process a claim.

18.43 Despite follow up work and revision of ROEs by the Commission's 106 specialists assigned to the task, errors (mostly in determining insurable weeks and earnings) in ROEs are still a major cause of errors in the processing of payments. The Commission, through its Comprehensive Tracking System, estimates that overpayments due to this cause amounted to $76 million and underpayments to $57 million in 1987.

18.44 Our 1987 Report stated (paragraphs 3.27 to 3.31) that the methods used to administer ROEs resulted in an overcharge to the government for its share of the cost of paying benefits amounting to $143 million for 1985 and 1986. The methods used by the Commission to determine benefit entitlement did not include a procedure to verify whether claimants had submitted all ROEs covering the qualifying period. As a result, errors in calculating the number of insurable weeks of employment have occurred, and the federal government has been overcharged for its share of the cost of benefit. These errors still exist; we estimate an overcharge to the government of $50 million for 1987. The Commission is introducing corrective measures in this area. We will continue to review the monitoring done by the Commission to ensure that no overcharge to the government occurs in future years.

18.45 Proposed administrative improvements. During our audit, a Commission task force with a mandate to conduct an in-depth review of the ROE system recommended means of facilitating the task of employers. The Commission proposed simplifying the regulations governing the determination of insurable earnings; assuming responsibility for calculating the twentieth week of insurable work; and allowing employers to submit computerized ROEs. The task force did not, however, assess the cost-benefit of several other ways to improve the ROE system that had been identified in the course of the study. These include a wage reporting system, the elimination of the minimum insurable earnings, and designating as not insurable any money paid or payable on separation. Its mandate was limited to changes that would not require amendment of the Unemployment Insurance Act.

18.46 The Commission should assess the cost-benefit of other means of improving the record of employment system identified by its task force, including those requiring amendment of the Unemployment Insurance Act.

> ***Commission's response:*** *The changes to the Record of Employment (ROE) (as described in paragraph 18.45) which will be implemented on January 1, 1989 and 1990 have received the full support of the employer community. Certain changes to the UI Act could indeed result in more radical changes in the ROE area, and the Commission will continue to work with the private sector to identify further possible improvements to the ROE system, including cost-benefit considerations, within the existing legislation. Should the legislation be re-examined, consideration will be given to other means of improving the ROE system.*

Program Effectiveness

18.47 Seven program evaluations of various aspects of the Unemployment Insurance Activity were completed between 1985 and 1987. Our review of these reports was intended to determine whether Employment and Immigration Canada has used satisfactory procedures to measure and report on the effectiveness of the activities in question. Three of the evaluation studies were satisfactory. We considered the other studies to be peripheral in that they did not address or report on key program objectives. For example; one study was narrow in scope and another, although addressing the appropriate questions, used inappropriate design and methodology.

18.48 In addition, the requirement of the 1983 program evaluation policy that "Employment and Immigration Canada will evaluate all its programs at least once every five years" has not been fully implemented. However, in recent years, several major reviews of the Unemployment Insurance Activity have been completed by groups independent of the Commission/Department. We have been informed that one of these reviews received important assistance from the program evaluation staff.

18.49 Employment and Immigration Canada should:

- **Improve its evaluation methods so that evaluation reports provide relevant answers to the major program questions; and**
- **Implement its evaluation policy with respect to the Unemployment Insurance Activity.**

***Employment and Immigration Canada's response:** The Commission will continue to maintain its persistent efforts to improve the evaluation methodologies used in responding to major program questions.*

Given the major reviews of the Unemployment Insurance Program, such as the Commission of Inquiry on Unemployment Insurance and the Standing Committee on Labour, Employment and Immigration, that have been completed in recent years, the Commission did not feel it necessary to implement its full evaluation policy and undertake further detailed studies. The Commission will review and implement, as required, a modified evaluation policy with respect to the Unemployment Insurance Activity.

National Employment Services

Introduction

18.50 National Employment Services has been an important part of the unemployment insurance system since 1940. Under the Unemployment Insurance Act, the Commission has a mandate to assist workers in finding suitable employment and employers in finding workers to meet their needs.

18.51 National Employment Services comprises three sub-activities: Labour Exchange, Labour Market Development Services and Labour Market Information. For 1987-88, the Commission expects to spend $252 million and devote 5,061 person-years to these activities; of that amount, $236 million (93.7 percent) will be recoverable from the Unemployment Insurance Account. The breakdown of forecasted expenditures and person-years for 1987-88, after prorating of support and overhead resources, is as follows:

	$ (000)	%	Person-years	%
Labour Exchange	115,219	46	2,758	54
Labour Market Development Services	106,046	42	1,763	35
Labour Market Information	30,963	12	540	11
TOTAL	252,228	100	5,061	100

18.52 The Labour Exchange sub-activity consists mainly of the placement services offered through Canada Employment Centres. Priority is given to helping employers in the private and the public sector to find suitable workers and to helping job seekers find work.

18.53 The second sub-activity, Labour Market Development Services, includes a number of services to promote and support the adaptation of individuals, communities, regions and industrial sectors to changing labour market conditions. In addition, they aim to promote equality of opportunity in access to jobs.

18.54 Finally, the Labour Market Information sub-activity involves the collection, processing and dissemination of information on labour markets.

18.55 The audit focussed mainly on the Labour Exchange sub-activity. We examined the management systems and practices used to control operations, systems for exchanging information between Employment Services and Insurance Services, performance measurement and procedures in place to measure and report on the effectiveness of the National Employment Services.

18.56 The audit was conducted at the Commission's national headquarters, in 5 regional offices and in 15 urban Canada Employment Centres (CECs) in these regions.

18.57 **Employment operations.** The Labour Exchange sub-activity involves gathering notices of job vacancies and keeping an up-to-date inventory of people available for work. Job vacancies are posted in Canada Employment Centres and advertised by various means as needed.

18.58 An integral part of services to clients – both employers and job seekers – is to identify their needs so as to determine the nature and level of services required. When a worker-client comes to a CEC, an interview is conducted if necessary to determine his or her service needs. Clients judged ready to work are directed to the self-service area where they can look through the inventory of vacancies to find something suitable. Other clients are directed to Labour Market Development Services, where a more detailed needs assessment can be conducted.

18.59 If a worker-client meets registration criteria described in paragraph 18.85, he or she may also be offered the opportunity to enroll in an inventory of workers. In this way, the worker-client may be notified when the CEC learns of a job opening corresponding to his or her qualifications and requirements.

18.60 Worker-clients interested in job vacancies are assessed by a counsellor or officer to determine whether they meet the needs of the employer. If they do, they are referred to the employer advertising the vacancy. Each referral is followed up to evaluate results and to determine whether the employer needs to see other candidates.

18.61 According to Commission data for 1986-87, some three million worker-clients were referred to employers by the National Employment Services (NES) to fill the 1.1 million full-time and casual job openings notified by employers. Through its various programs, the NES was able to fill 829,600 of these vacancies.

Revitalization of Employment Services

Following the Revitalization Process started in 1982 the Commission introduced significant improvements in some of its Employment Services

delivery mechanisms. However, we were not able to determine their overall effect on the efficiency and effectiveness of operations due to the fact that performance indicators had not been selected and program evaluation results were not yet available.

18.62 Several of the groups that have examined the National Employment Services in this decade have recognized the need for changes in service delivery mechanisms. In 1981, the Task Force on Labour Market Development (the Dodge group) made several recommendations to improve operations. The following year, when unemployment was very high and the expectations of clients were growing steadily, the Commission set up a National Steering Committee with a mandate to analyze Employment Services operations and to recommend how they could best respond to the present and foreseeable needs of the labour market.

18.63 The Committee's recommendations led to the Revitalization Process, which included a restructuring of Employment Services and modifications in CEC mechanisms to ensure better targeting of those parts of the labour market not well served by existing mechanisms or institutions.

18.64 The Revitalization Process was accelerated in 1985, on the recommendation of the Task Force on Program Review (the Nielsen Task Force). By September 1987 the process had been largely completed.

18.65 The revitalization of Canada Employment Centres enabled the Commission to introduce significant improvements in some of its service delivery mechanisms, including:

- the definition of clients' needs;
- selective registration of job seekers;
- greater reliance on self-service;
- computerization of information on jobs and worker-clients;
- establishment of local intervention plans;
- labour market information; and
- training for employment counsellors.

18.66 Until performance indicators have been selected and program evaluation results are available, it will not be possible to determine the effect of these changes on operational efficiency and effectiveness.

18.67 **Performance measurement**. National Employment Services management is responsible for developing and using performance indicators to evaluate and monitor the use of resources allocated to the service.

18.68 The Employment and Immigration Information System now captures information on 73 units of business for Employment Services. Units of business are actual data on workload volumes such as the number of vacancies filled. By comparing one unit of business to another or to information on resources used, Employment Services can obtain some productivity or operational effectiveness indicators such as the number of placements per person-year or the percentage of employment vacancies filled.

18.69 However, National Employment Services has not yet selected those performance indicators which will provide the best means of objectively assessing the efficiency of Employment Services. Additional indicators will also have to be developed to measure performance in other important aspects of operations such as the quality and the speed of service.

18.70 In January 1987, the Treasury Board approved Employment and Immigration Canada's Operational Plan Framework, despite reservations about the performance indicators established for National Employment Services. The Treasury Board then asked for the development of performance indicators for this activity as soon as possible. In March 1987, the Commission indicated in its response that performance indicators were in the process of being modified as part of the revitalization of Employment Services.

18.71 Our audit showed that various projects have been initiated, at National Headquarters and in some regions, in order to develop performance indicators to measure the speed and quality of service, as well as the productivity and efficiency of National Employment Services operations. At 30 June 1988, no national performance indicators had been introduced as a result of these initiatives.

18.72 **The Commission should complete its development and selection of relevant indicators to measure the speed and quality of service, as well as the productivity and efficiency of resource usage by National Employment Services.**

> ***Commission's response:*** *The Commission believes that, in most cases, adequate performance indicators are available to effectively manage Employment Services. Surveys to measure the quality of service to worker clients have been implemented at the local office level, while employer surveys are currently being tested in all regions. In addition, the information is available to produce indicators on the efficiency of resources usage. The Commission will complete the development and selection of indicators before December 31, 1988.*

18.73 **Program effectiveness.** Employment and Immigration Canada undertook an evaluation of National Employment Services activities in 1986-87. The objective was to examine the effectiveness of Employment Services and to determine the extent to which the Revitalization Process had contributed to improving services to employer-clients and worker-clients. We have been informed that the evaluation report would not be available until the fall of 1988.

Matching Job Seekers with Vacancies

> **We noted deficiencies in the methods used to match job vacancies with job seekers when the self-service approach did not result in filling a vacancy.**

18.74 One of the objectives of the Labour Exchange sub-activity is to match job opportunities with available workers so that employers get the skilled workers they need in a timely and effective manner. To this end, matching job seekers with vacancies is the principal activity.

18.75 To match job vacancies with available workers efficiently and effectively, the CECs need appropriate mechanisms for recording and disseminating information on the opportunities employers have open and for finding suitable workers to fill them.

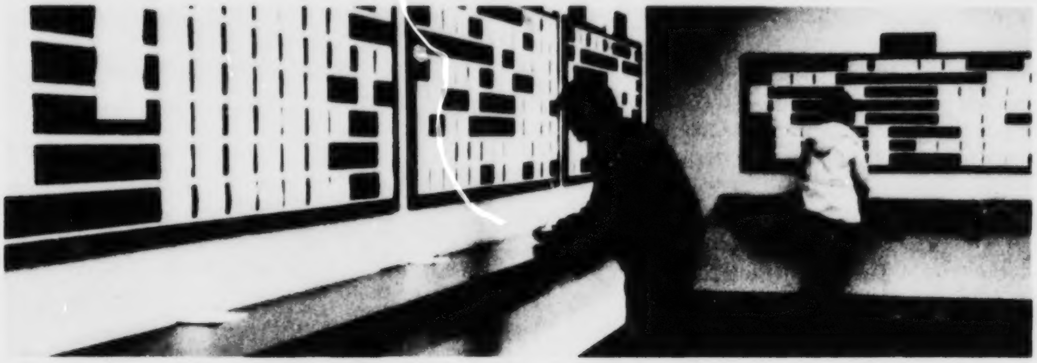
18.76 One such mechanism is the National Employment Services System (NESS), a computerized inventory of worker-clients and job vacancies that has been installed in all CECs in the country's large urban centres. All job vacancies are entered in the system. Workers looking for jobs are registered on a selective basis for labour exchange purposes if they meet certain criteria (see paragraph 18.85). The system is used to manage information received on job openings and to search for candidates to fill job vacancies.

18.77 **Inventories of job opportunities.** The audit showed that, for the majority of cases in our sample, notices of job opportunities contained complete and clear information on the necessary qualifications, the duties to be performed and the conditions of employment.

18.78 We noted in some instances that CECs do not always record the correct number of openings that employers have to offer. As a result, the rate for filling job vacancies – which is one of the performance indicators used by National Employment Services – tends to be overstated. This observation was also made during internal operational reviews conducted by the Commission.

Self-service Job Matching

18.79 Since the Revitalization of Employment Services, CECs have been placing an increased emphasis on self-service mechanisms to match vacancies with job seekers. CECs have adopted two methods of posting job vacancies, according to the needs of employer-clients. Commission data show that the self-service approach has been used to fill 41 percent of vacancies about which CECs were notified between April and December 1987.



Increased emphasis is placed by CECs on self-service mechanisms such as the use of job information centres (see paragraph 18.79).

18.80 The first method is to post jobs in the employment information centre without any indication of the employer's name. Interested worker-clients are interviewed by a counsellor or officer who assesses their qualifications to ensure that they meet the job requirements. Qualified candidates are then referred to employers.

18.81 The second method used to disseminate information on employers' labour needs is the "open display" method, which consists of identifying the employer on the card posted at the employment information centre along with the job duties and qualifications. In this way, prospective candidates can contact the employer directly without any involvement by the CEC.

18.82 At the time of our audit, the second method was not in widespread use, except in one province. Results in that province show that the method can be effective for certain types of job openings. In November 1987, the Commission issued a revised policy on job order management which provides guidelines on the utilization of "open display". In our view, if the Commission made greater use of this method of disseminating information, resources could then be freed for other purposes.

18.83 **The Commission should make greater use of job postings that identify the employer, where these would be appropriate for meeting employers' needs.**

> ***Commission's response:*** *The Commission agrees that open display orders should be used to disseminate information on job orders in cases where this level of service corresponds to the needs of the employer. As such, the level of service that each employer order will receive is negotiated with the employer as part of the service agreement. As pointed out in paragraph 18.82, a revised policy on job order management was introduced at the same time as the audit was taking place. Since that time, the use of open display orders has increased to the point where there is usage of this approach in all regions. The degree of usage will be carefully monitored with a view to encouraging increased usage where it is warranted.*

Matching Through the Inventory of Worker-clients

18.84 When the self-service approach is not successful in filling a vacancy, CECs should be able to refer to the National Employment Services System (NESS) computerized list of worker-clients to find candidates. We examined the procedures used by each CEC to register worker-clients as well as the timely use of inventories by Employment Services.

18.85 **Registration of worker-clients**. Prior to the revitalization of Employment Services, all job seekers who presented themselves to a CEC were registered in an inventory of candidates. Following test trials in selected CECs, the Commission issued a new registration policy in May 1987. According to this new policy, candidates who meet the following criteria are to be registered in the inventory:

- clients who for valid reasons (e.g., day care, distance, accessibility) are unable to avail themselves of the self and group service provided by the CEC in order to meet their employment needs; and
- qualified workers, who labour market information indicates are in short supply, and for whom self-service facilities are not adequate to meet employers' requests.

18.86 There were significant differences in the application of this registration policy by the CECs we visited. At some centres, Employment Services had not identified jobs where labour was in short supply or jobs that were difficult to fill with the self-service approach. In one centre there was a list of such jobs, but it was not used to register clients. In addition, as pointed out in paragraph 18.102, CECs were not systematically applying registration policies with respect to unemployment insurance recipients.

18.87 Our sample of worker-client registrations showed that, in a number of cases, the information necessary to match candidates with vacancies effectively - such as level of education and work experience - was not included.

18.88 The candidate's occupational code is one of the elements used to match job seekers with vacancies through computerized employment inventories. We noted that the present coding system (the Canadian Classification Dictionary of Occupations or CCDO) used to enter jobs and workers in NESS is of limited usefulness in matching jobs and job seekers.

18.89 Under the CCDO system, workers are entered in the inventory under a code describing the type of job they held, rather than their skills or qualifications. Thus, because NESS allows matching of candidates and vacancies only by type of job, its usefulness is hampered.

18.90 Recognizing this problem, the Commission launched a project to develop a new job classification system at a cost of $2.8 million. At the same time, the Commission is developing a new system for collecting information on job vacancies and worker-clients (JOBSCAN), which should, among other things, improve the quality of information used to match jobs and job seekers.

18.91 **Consulting the worker inventory.** Our review of computerized inventories on worker-clients in short-supply occupations at the CECs we visited showed that they were not always used in an efficient and effective manner.

18.92 A review of 515 job vacancy notices posted at CECs showed that, in almost half of these cases, the CECs in question were not able to refer candidates to employers within 48 hours of receiving the notice (the Commission's standard of service until November 1987). In many cases, however, we found worker-clients listed under these types of jobs in the National Employment Services System (NESS) computerized inventory.

18.93 The policy on the use of NESS computerized inventories does not require that job vacancies for which worker-clients have been registered be matched systematically. Such a practice has the potential to create for some worker-clients the expectation that, because they have been entered in the inventory, they will be called if the CEC receives notice of a job vacancy that matches their qualifications.

18.94 **Canada Employment Centres should maintain suitable inventories of worker-clients, in accordance with the national registration policy, and should refer these candidates to employers in a timely way when the self-service approach does not result in a job vacancy being filled.**

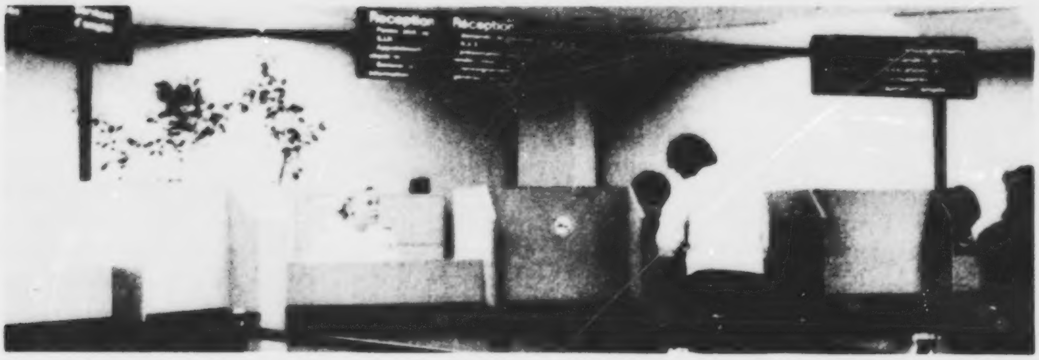
> ***Commission's response:*** *According to existing policy, worker-clients who meet the criteria outlined in paragraph 18.85 should be asked to complete an employment registration for the labour exchange inventory so that the client can be referred to appropriate vacancies as these are received. The policy was promulgated in May 1987, shortly before the audit took place. This would account for the majority of differences in the application of the registration policy. The Commission will monitor the application of the policy in field offices with a view to achieving consistency.*

Integration of Employment and Unemployment Insurance Services

Insufficient co-ordination and communication between Employment and Insurance Services hinder the prompt re-employment of unemployment insurance claimants. Prompt re-employment could potentially reduce the amount paid out in unemployment insurance benefits.

18.95 One of the main reasons for integrating the Department of Manpower and Immigration and the Unemployment Insurance Commission in 1977 was to improve co-ordination and harmonization of the services offered to unemployment insurance beneficiaries by the two organizations.

18.96 Our audit showed that the Commission needs to improve its operational practices at some Canada Employment Centres (CECs) to fully realize the results expected at the time of integration. Insufficient co-ordination between Insurance and Employment Services



The reception area of a Canada Employment Centre shows Employment and Unemployment Insurance Services together (see paragraph 18.95).

concerning referral and registration of UI claimants prevents the Commission from realizing potential savings in unemployment insurance payments. In addition, weaknesses noted in the communication of claimant information to Insurance Services and in Interview Programs are significantly affecting the efficiency and effectiveness of the mechanisms set up by the Commission to control the eligibility of UI recipients.

Referral of UI Claimants to Employers

18.97 Management at the CECs we visited confirmed that job vacancies were not always taken into account immediately when worker-clients who were ready to work presented themselves at the employment centre to register for UI benefits.

18.98 In examining a limited number of applications for UI benefits, we noted some cases where job vacancies for which those UI applicants were qualified were posted in CECs without applicants being referred to employers. In some instances, wages offered by employers were higher than those received by UI applicants in their previous jobs.

18.99 The Commission should refer worker-clients, especially those in short-supply occupations, to employers if suitable jobs for which they are qualified are posted at the Canada Employment Centre when worker-clients arrive to apply for unemployment insurance benefits.

> ***Commission's response:*** *The Commission agrees that worker-clients, in short-supply occupations, filing in-person claims, should be registered for employment and placed in the labour exchange inventory and referred to available vacancies as appropriate. As such, these claimants would be referred to employers if suitable vacancies for which they are qualified are available at the Canada Employment Centre. UI claimants, in other occupations, filing in-person claims, will have available to them a range of alternative employment services including self and group services.*

Registration of UI Claimants

18.100 Prior to the revitalization of Employment Services, all UI recipients had to be registered with Employment Services. The new May 1987 policy on the registration of worker-clients requires that only UI recipients who meet certain conditions (listed in paragraph 18.85) must register with Employment Services if they wish to retain their eligibility for benefits.

18.101 On the basis of our examination we concluded that Employment Services in most of the CECs we visited did not systematically register beneficiaries who meet the Commission's criteria for compulsory registration.

18.102 The registration of UI recipients varied significantly from one CEC to another. For example, our audit showed that one CEC had registered 85 percent of UI recipients who met the criteria for compulsory registration while another had registered only 10 percent. The overall rate for the CECs we visited was only 32 percent. Non-compliance with the registration policy on UI claimants renders the worker-client inventory incomplete and reduces CECs' access to potential suitable candidates to fill job vacancies.

18.103 The Commission should ensure that unemployment insurance recipients are registered with Employment Services in accordance with existing policies.

> ***Commission's response:*** *The existing policies were promulgated in May 1987, shortly before the audit took place. This accounts for a high proportion of the variances noted in paragraph 18.102. The Commission will monitor the application of the registration policy in field offices with a view to ensuring consistency.*

18.104 Weaknesses noted above hinder the prompt re-employment of UI beneficiaries. Employment Services does not monitor the number of UI beneficiaries placed by CECs. Finding employment for beneficiaries is not among the performance criteria set for CECs. Less money would have to be paid out if greater efforts were made to help beneficiaries return to the work force more quickly. This is particularly true in some large metropolitan areas where the level of job vacancies is high.

18.105 Commission data show that, as of December 1987, the average duration of UI benefits was 22 weeks, with average weekly benefits at $200. Given that National Employment Services places some 650,000 worker-clients in full-time jobs (five days or more according to Employment Services definition) each year, any change in the number of placements of UI recipients could have a significant impact on the amount of unemployment insurance benefits paid out.

18.106 For example, each percentage point increase in the total number of full-time placements could result in savings of up to $1.3 million a week in UI payments if these placements are UI beneficiaries. Since the Commission does not keep information on the average period of employment of worker-clients placed by CECs, we were unable to extrapolate the potential savings over that average period of employment.

Communication of Claimant Information to Insurance Services

18.107 The Unemployment Insurance Act requires that recipients of unemployment insurance benefits be available and actively looking for work if they want to remain eligible for benefits.

18.108 The Commission's Employment Manual elaborates on this requirement as follows: "Employment is responsible for assisting Insurance in preserving the integrity of the UI program by identifying any individuals who may not be fulfilling the conditions of entitlement to benefits."

18.109 To carry out this responsibility, National Employment Services has set out policies regarding the provision of claimant information to Insurance Services in cases where a claimant referred to an employer for a vacancy failed to appear for the interview or turned down an offer of suitable employment.

18.110 The audit revealed that Employment Services in most of the CECs visited did not have an adequate system for effective control of UI claimants who fail to report to an employer for a job interview. As the control system relies on the word of the employer versus the word of the worker, CECs are often not in a position to determine whether a UI claimant actually went to an interview with an employer. As a result, in most CECs visited, Employment Services had ceased providing information to Insurance Services about "fail to report" cases.

18.111 In most of the CECs visited, Employment Services did not provide information to Insurance Services on the placement of claimants. The rationale was that clients should be responsible for informing Insurance Services themselves of any change in their situation. Nevertheless, in one CEC, this information exchange was taking place and allowed Insurance Services to discontinue benefits right from the time the client found a job.

18.112 **The Commission should improve the exchange of information between Employment and Insurance Services with respect to UI claimants who fail to present themselves for employment interviews or who have found jobs, especially those in short-supply occupations.**

> ***Commission's response:*** *The Commission's policy on the provision of claimant information to Insurance Services, as set out in Chapter 5 of the Employment Services Manual, adequately covers cases of claimants who failed to present themselves for employment interviews or who have found jobs. The Commission is now studying different methods and procedures for applying the policy in a more effective manner.*

Interview Programs

18.113 Insurance Services has established several interview programs to enforce the Unemployment Insurance Act with respect to the availability of, and active search for work by, UI recipients. The three programs are Increased Interview Activity, Active Job Search and Continuing Entitlement Interviews.

18.114 The Active Job Search program requires UI claimants with qualifications in short-supply occupations to regularly submit a list of the employers they have visited. None of the CECs visited had implemented this program. In light of the deficiencies noted in paragraphs 18.98 and 18.101 with regard to referring claimants to employers and registering them with Employment Services, we believe that claimants qualified in job areas with labour shortages are not subject to appropriate monitoring with respect to their job search activities.

18.115 The Commission should improve its monitoring of the active job search activities of unemployment insurance claimants who are qualified in professions or trades where a shortage of labour exists.

> ***Commission's response:*** *The Commission's current Interview Program addresses ongoing entitlement issues, including job search activities of claimants. A working group has been established to review the current status of the Active Job Search activity and to recommend the most cost effective approach to monitoring claimant's job search in line with existing jurisprudence.*

Information for Parliament

18.116 Our examination included Part III of the Estimates for 1987-88 and 1988-89 for the Insurance Operations and Labour Exchange activities.

18.117 Employment and Immigration Canada is obliged to follow the Estimates format set out by the Office of the Comptroller General. However, because each of the Commissions activities and sub-activities is treated under the prescribed headings, it is difficult for the reader to easily and quickly grasp all the relevant information concerning a given activity and its components. For example, to find all the information on one activity of the Employment and Insurance Program, it is necessary to consult up to five different sections of the chapter. Moreover, in the 1988-89 version, there are more than 75 cross-references to additional information (see Exhibits 5.2 and 5.4 of Chapter 5 of this Report). We noted in paragraph 18.69 that information on performance indicators for the National Employment Services program is incomplete.

Financial Status of the Unemployment Insurance Account

18.118 Our 1983 Report drew attention to the extent of the deficit of the Unemployment Insurance Account at December 1982. Exhibit 18.6 shows how the deficit/surplus has evolved between 1982 and 1988. The relative stability of premium rates for this period was realized at the expense of significant interest charges over the same period.

Exhibit 18.6

CHANGES IN THE DEFICIT/SURPLUS OF THE UI ACCOUNT
1982-88

Year	Unemployment Rate	Approved Premium Rate	(millions of dollars) Annual (Deficit) Surplus	Cumulative (Deficit) Surplus	Interest Charges
1982	11.0	1.65	(2,728)	(2,397)	89
1983	11.9	2.30	(1,457)	(3,854)	409
1984	11.3	2.30	(692)	(4,446)	453
1985	10.5	2.35	101	(4,445)	522
1986	9.6	2.35	653	(3,792)	463
1987 (1)	8.9	2.35	1,525	(2,267)	270
1988 (1)	7.8	2.35	2,671	404	82

(1) Forecast at 30 June 1988

18.119 To cover 1982's unprecedented deficit, the premium rate for 1983 was raised by almost 40 percent, from $1.65 to $2.30 per $100 of insurable earnings. In 1985, the premium rate was raised to $2.35 as required by the UI Act. For 1986 and 1987, the premium rates remained at the 1985 level by means of legislative amendment, since annual surpluses were already provided for with the rate of $2.35. The cumulative deficits of 1982, 1983 and 1984 will be completely eliminated by December 1988.

18.120 During 1986, as a result of changes to the government accounting policies, the UI Account was consolidated into the Government of Canada accounting entity. As a result, the UI Account surplus of $1.7 billion for the period ending 31 March 1988 was consolidated into the Consolidated Revenue Fund, thus reducing the annual deficit of Canada by the same amount.

18.121 The Account is expected to be in a cumulative surplus position by the end of 1988. We draw to Parliament's attention that it would be desirable to continue to maintain a reasonable surplus position in the Account to provide relative stability in the premium rate and protection against unexpected cost increases.

SPECIAL AUDITS

SPECIAL AUDITS

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SPECIAL AUDITS

Main Points

SUSPECTED FRAUD REPORTING PROCEDURES

In 1984-85, we found government procedures to report suspected fraud to be inadequate. Our current audit examined the extent to which six departments were complying with subsequent Treasury Board policy directions issued in 1987. (paragraphs 19.3 to 19.6)

In our opinion, progress has not been satisfactory. Most of the six departments examined had not established the required procedures for reporting all suspected cases of fraud and other offences or for reporting violations of the Financial Administration Act (FAA) and its regulations. Also, they had not adequately informed all employees of the legal obligation under the FAA to report suspected losses of money, fraud and violations of the FAA, and how and to whom reports should be made. (19.7 to 19.13)

We were concerned that individuals would be reluctant to report for fear of reprisals and that the wide dispersal of records of cases in various branches of departments might lead to unfairly damaging innocent persons. We recommended that the identity of such individuals and all related records should be protected. (19.14 to 19.18)

In January 1988, the President of the Treasury Board asked ministers to request that management of their Crown corporations establish fraud reporting procedures and report offences to the RCMP. We plan to review the adequacy of these procedures in the future. (19.19 to 19.22)

MAJOR CAPITAL PROJECTS

We examined six projects with a total cost of $250 million that represented construction activity within the federal government by various departments. In two cases, planning took from 10 to 13 years; in the third, it is still continuing after 15 years. In consequence, in one project the usable space constructed was substantially larger than planned without supporting justification for the increase. Our concern is that needs may change over such a long period and may not be reflected in the final product. (paragraphs 19.31 and 19.48)

For the proposed Animal Virus Laboratory, we found insufficient justification to support the initial decision to contruct – a decision withdrawn for financial reasons. Although the Animal Disease Research Institute was within the Treasury Board approved budget, there was insufficient analysis of alternatives. The Government of Canada Building in Edmonton, acquired under a lease purchase agreement, was built with deviations from the National Building Code which will affect some fire resistance and floor loading capacities. (19.43 and 19.46)

We examined lease purchase as a method of acquiring government accommodation and concluded that it is not economical compared to construction by the Crown. (19.44)

SPECIAL AIR SERVICES

Government departments often need air services not normally provided by commercial carriers. In such circumstances, they acquire them by charter, lease, lease purchase or outright purchase. (paragraphs 19.71, 19.72)

Seven government departments, excluding National Defence and Transport, spent $55.7 million in 1986-87 to operate 55 Crown-owned aircraft and to contract for 534 charters or leases. Current departmental regulations and directives were followed, and the use of aircraft was linked to approved program objectives. (19.73 to 19.78)

However, there are no government-wide directives relating to acquisition or management of aircraft and no uniform basis for obtaining cost information for budgeting and accounting for the use of aircraft services. (19.78 to 19.83)

We found distinct weaknesses in the planning, options analysis, pricing and availability and final definition stages of project management. The most common fault was the absence of in-depth economic analysis to support purchase, lease or charter decisions. (19.83 to 19.85)

MULTIPLE SOURCE SUBSIDIES

The objective of this special audit was to assess whether there is a significant risk that projects may be funded under more than one government program without the knowledge of other donor departments or in contravention of government policies. (paragraph 19.152)

We reviewed 114 contributions made to 21 commercial enterprises from eight departments, and found that few projects were funded under more than one government program. However, in the case of research and development projects receiving support from more than one program, communication between donor departments was weak and the risk of double funding was present. (19.154 to 19.156)

SPECIAL AUDITS

Introduction

19.1 The Special Audits group examines specific programs and activities within a department or across several departments. These topics would normally not be examined by means of comprehensive audits or government-wide audits. This approach allows the results of Special Audits to be reported quickly to Parliament and, at the same time, increases the efficiency and effectiveness of the Audit Office.

19.2 The topics included in this year's chapter are Suspected Fraud Reporting Procedures, Major Capital Projects, Special Air Services and Multiple Source Subsidies.

SUSPECTED FRAUD REPORTING PROCEDURES

Reporting of Suspected Fraud and Other Offences Against the Government of Canada

19.3 In 1984-85 we reviewed procedures in 13 departments for reporting suspected fraud and other offences and violations of the Financial Administration Act (FAA). The 1984-85 audit was initiated partly in response to 1983 amendments to the FAA, concerning losses of money and public property. The amendments empowered the Governor in Council, on the recommendation of the Treasury Board, to make regulations prescribing the actions to be taken in the event of such losses.

19.4 We found significant deficiencies in departmental procedures. We reported these findings to the President of the Treasury Board in 1985 and summarized them in our 1987 Report to Parliament.

19.5 In response to the FAA amendments and our 1985 report to the President of the Treasury Board, the Treasury Board issued, in February 1987, a policy circular on investigating and reporting "Losses of Money Suffered by Her Majesty and Offences and Other Illegal Acts Against the Crown".

19.6 Our 1987-88 audit examined the extent to which reporting procedures in six departments were in compliance with the Treasury Board policy. Five of the six departments had been reviewed in 1984-85. We examined how the departments were implementing the Treasury Board procedures. Our examinations were not designed to identify all known offences or to detect unknown instances.

19.7 In our opinion, progress has not been satisfactory.

19.8 Most of the six departments examined had not established the procedures required by the Treasury Board for reporting all suspected cases of fraud and other offences to the RCMP, the Deputy Attorney General and the Treasury Board, and for reporting all proven cases to Parliament. In addition, most of these departments had not implemented the required procedures for reporting violations of the FAA and its regulations.

19.9 In particular, they had not:

- established a fully functioning independent co-ordinating centre responsible for receiving reports of suspected fraud and other offences and violations of the FAA, and for reporting to the deputy head, the RCMP, the Deputy Attorney General, the Treasury Board and Parliament as required; or
- adequately informed all employees of the legal obligation, imposed by Section 92 of the FAA, to report their knowledge or information of suspected losses of money, fraud and violations of the FAA, or how and to whom reports should be made.

19.10 We reviewed how cases identified by departments has been managed. We found that cases were reported to co-ordinating centres or were reported after substantial delays. Some departments carried out investigations without first referring the cases to the RCMP to determine what investigation should be undertaken and by whom. Moreover, some cases had not been reported to the RCMP, the Deputy Attorney General or the Office of the Comptroller General. During the period of the audit, both the RCMP and the Department of Justice sent letters to departments reinforcing the requirement to immediately report to the RCMP all suspected offences. We are concerned about the tendency by some departments to not always report cases to the RCMP.

19.11 We also found gaps in reporting to Parliament. For example, our general review of reporting disclosed that, in the 1986-87 Public Accounts, losses of money as a result of fraud or willful misrepresentation on the part of the public against the Income Tax Act had not been reported. However, in 1985-86 $27.7 million in losses were disclosed. We have discussed this matter with the Office of the Comptroller General, which confirmed that the Treasury Board policy requires reporting such losses.

19.12 We have also discussed the matter with National Revenue-Taxation. The Department feels that the reporting of assessments resulting from Special Investigations would be misleading and incomplete if the intention is to reflect losses of money due to fraud.

19.13 **Departments should immediately comply with the reporting procedures required by Treasury Board for incidents of suspected fraud or other offences and FAA violations.**

Confidentiality of Reports

19.14 The FAA requires virtually all public servants to report violations of the FAA or its regulations or any revenue law, and frauds committed by any person against the government.

19.15 Persons failing to do so are guilty of an indictable offence and are liable on conviction to a fine not exceeding $5,000 and to imprisonment for a term not exceeding five years.

19.16 In our opinion, the penalty for failing to report should be balanced by protection for those who do report. In 1985 we advised the President of the Treasury Board that departments had expressed concern that individuals reporting suspected illegal activities could be subjected to harassment. We were concerned that individuals would be reluctant to report suspected violations for fear of reprisal, especially from superiors, while at the same time being subject to penalties for not reporting. We recommended that the Treasury Board advise departments of their responsibility to safeguard the identity of persons who report. We also recommended that the Board determine whether additional legal safeguards were required, for example, amending the Privacy and Access to Information Acts. Treasury Board officials indicate that this is a difficult matter to resolve. Nevertheless, we recommend that the matter be addressed as quickly as possible.

Protection of the Accused

19.17 A system for reporting offences must also protect the identity of accused persons where no disciplinary action is taken or charges laid. We have found records of such cases filed in various branches of departments, including personnel. We are concerned that such wide distribution of records may lead to damaging the reputation of innocent persons.

19.18 All records relating to an allegation of fraud or other offence and violations of the FAA should have the same legal status as similar RCMP records, and the same requirements for confidentiality, storage and retention. In particular:

- **the identity of persons reporting suspected fraud and other offences and violations of the FAA to departmental officials should be protected to the same extent as that of persons who report such cases directly to the RCMP;**
- **the identity of a person suspected of a fraud or other offence or of FAA violations should be kept confidential until the allegation has been proven;**
- **no record of an unsubstantiated allegation of fraud or other offence or violations of the FAA should be retained in departmental files outside the direct control of the independent co-ordinating unit, particularly not in personnel files; and**
- **records relating to an unsubstantiated allegation of fraud or other offence or violations of the FAA should be kept for no longer than similar RCMP records.**

Crown Corporations

19.19 In 1987 we reported that, in response to our recommendations, the President of the Treasury Board was considering writing to ministers responsible for Crown corporations, requesting that they ask the corporations to ensure the establishment of adequate procedures for reporting fraud and other offences.

19.20 In January 1988 the President of the Treasury Board wrote to ministers, requesting that they inform Crown corporations that it would be highly desirable to ensure that reporting systems were in place that would allow losses of money and property of any material size to be brought quickly to the attention of corporate management. He also advised that cases of fraud and other illegal activity should be independently investigated by the RCMP.

19.21 At the time of this report, most of the Crown corporations audited by our Office have confirmed their receipt of this direction. Treasury Board officials indicate they will follow up on instances where the letter has not been received.

19.22 We plan to review the adequacy of these procedures in subsequent audits.

Losses of Public Property

19.23 In 1987 we reported that the Treasury Board had not yet issued specific directives to advise departments on how losses of public property due to fraud and other illegal activity should be reported to Parliament, or that such losses are subject to existing directives and policies on security of material and on claims regulations.

19.24 A draft circular on the loss of property has been prepared by the Treasury Board, but at the time of writing this report it had not been finalized and issued to departments.

MAJOR CAPITAL PROJECTS

Introduction

19.25 As part of our continuing examination of capital acquisitions by the federal government, we looked at six projects with total costs approaching $250 million. The projects were representative of construction activity undertaken by various federal departments. Three of the projects were examined in support of the audits of the Department of Indian Affairs and Northern Development, and the Department of Fisheries and Oceans and the special examination of the National Capital Commission. The other three projects discussed in this chapter show planning or implementation deficiencies that departments could correct at little cost.

Audit Scope

19.26 We examined each project using methodology and criteria developed by the Office of the Auditor General and agreed to by the departments concerned. We assessed each project from the time departments had identified the need for a construction project up to the point the project had reached at the time of our audit.

19.27 We focussed on departmental processes used to develop plans for capital projects, and the methods used to manage them. We attempted to determine the relationship between projects and departmental plans and objectives, with particular reference to the strategies for achieving objectives.

19.28 We examined the project management systems in use, to assess the extent to which they complied with existing regulations and met the agreed criteria.

19.29 We also looked at contracts to assess whether the departments and the service agency, the Department of Public Works (DPW), had followed departmental and Treasury Board directions in developing appropriate contractual arrangements for each project.

19.30 Depending on the state of completion of particular projects, we examined the commissioning phase (the phase in which the equipment or construction is turned over to the Crown) to assess whether the department had received the equipment or building for which it had contracted.

Audit Findings

19.31 **Planning.** In two of the three cases, detailed planning took from 10 to 13 years. In the third case, planning is still in progress after 15 years. As a result, one research centre has substantially more usable space than originally planned. Our concern is that in some cases actual requirements change significantly as time passes, and these changes may not be reflected in the final acquisition.

19.32 **Needs definition and options analysis.** In the case of the Department of Agriculture's proposed Animal Virus Laboratory in Nepean, Ontario, we did not find sufficient analysis to justify the initial decision to construct, a decision later withdrawn for financial reasons. In another case – the Animal Disease Research Institute in Lethbridge, Alberta – we found that as a result of insufficient analysis of options, such as alternative locations or the possibility of consolidating with similar existing or proposed projects, the Department of Agriculture could not determine if it had, in fact, obtained the most economic structure for its purposes.

19.33 **Implementation.** We noted that in a structure erected under a lease purchase agreement there were deviations from National Building Code requirements which, although detected by inspectors, were not corrected at the time of our audit. Some of these may impact on the life of the structure.

19.34 **Reporting to Parliament.** We found incomplete reporting to Parliament. A 10-year management agreement of $3.4 million annually, as well as costs of $33.7 million for a land assembly agreement, were not reported as part of the cost of one project.

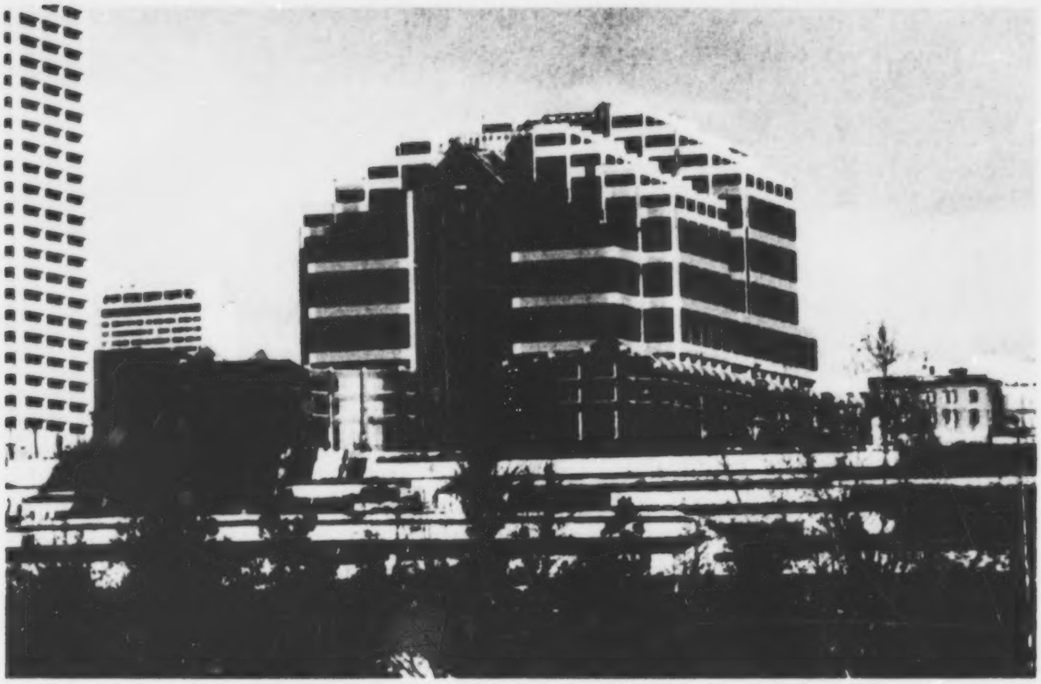
19.35 **Lease purchase.** We examined lease purchase as a method of obtaining government accommodation and concluded that this form of capital acquisition is not economical compared to Crown construction.

Case Study 1

Government of Canada Building
Edmonton, Alberta

19.36 The Department of Public Works provides accommodation for federal public servants. In 1970, DPW examined the option of integrating a new office building with a proposed development by the City of Edmonton. Discussions with the City and the Province of Alberta continued until 1983, when DPW was given approval to acquire a parcel of land to construct a building that would accommodate the majority of Edmonton-based federal public servants, create a "central federal presence", and meet the redevelopment needs of both the Province of Alberta and the City of Edmonton. In 1984, DPW was given approval to sign a lease purchase agreement with a developer. The cost of the project was reported to Treasury Board in terms of net present value at $152.2 million in 1984.

19.37 In its 1985-86 Estimates report to Parliament on the cost of the project, DPW did not include several significant facts, notably that a management agreement worth $34 million over a 10-year period was an integral part of the agreement with the developers and that the cost of land was $33.7 million. The Department has stated that its reporting format had the agreement of the Office of the Comptroller General and the Treasury Board.



Government of Canada Building in Edmonton, Alberta. This building was constructed to consolidate office space for federal employees in Edmonton (see paragraph 19.36).

19.38 DPW had requested a number of developers to submit design and construction proposals based on performance specifications. From the initial respondents, a short list of five was invited to present fully developed proposals. DPW had Treasury Board approval to make payments of up to $30,000 to developers whose bids proved unsuccessful. In the end, DPW paid $50,000 to each of the two unsuccessful bidders who had submitted proposals – in effect making, without appropriate authority, two ex gratia payments of $20,000 each.

19.39 We concluded that DPW had examined the requirements for office space at various times during the planning phase between 1970 and 1984, culminating in a study in 1983. We are satisfied that the needs analysis was adequately done.

19.40 Two options were possible for meeting the accommodation needs of the federal government: either continue to rent space in various buildings in the city, or build a new building. Given the direction to create a "central federal presence", the rental option was of interest only as a financial alternative. We concluded that DPW had properly analyzed the options of renting or building.

19.41 We examined the pricing and availability analysis presented to the Treasury Board in seeking Effective Project Approval to sign a lease purchase agreement with the developer. The Department indicated that the lease purchase option was, in 1984 net present value terms,

$13.1 million more expensive (including developer's charges and higher costs of borrowing). The Treasury Board directed the Department to proceed with the lease purchase option. In our 1986 Report we identified a similar occurrence in the acquisition of the Guy Favreau Complex in Montreal. We noted then that, in analyzing the options, the Department had used the Real Estate Investment Analysis System (REIAS), which sometimes requires manual calculation to undertake cost analysis of all options. When this is not done, as was the case again here, the Department is unable to present the full range of possible costs that may follow from any one option. The Department acknowledges that a sensitivity analysis should be done as part of the overall assessment of risk.

19.42 In sum, the government acquired a building that cost about $80 million to construct, but for which it has paid and will continue to pay a higher sum. We calculated that in current year dollars the additional cost will be approximately $100 million (or $13.1 million in 1984 net present value). Even though Treasury Board was advised of the higher cost, the Department was directed to acquire the building on the basis of lease purchase which, we calculate, will cost almost 20 percent more than the alternative of Crown construction.

19.43 We noted that, in conducting regular progress inspections and reporting on deficiencies, DPW had brought to the notice of the developers construction practices which, if left unresolved, would reduce fire resistance. At the time of our audit, several of these matters had not been resolved. The reported instances also reflect construction practices that affect the load bearing capacity of some floor slabs, which the Department advises us will require remedial work. Although the Department noted and reported major deficiencies during construction, it was not always advised of corrective action by the contractor. Corrective action to remedy some of these deficiencies has been taken and is continuing, but no assurance has been given that all of them will be corrected to the Department's satisfaction.

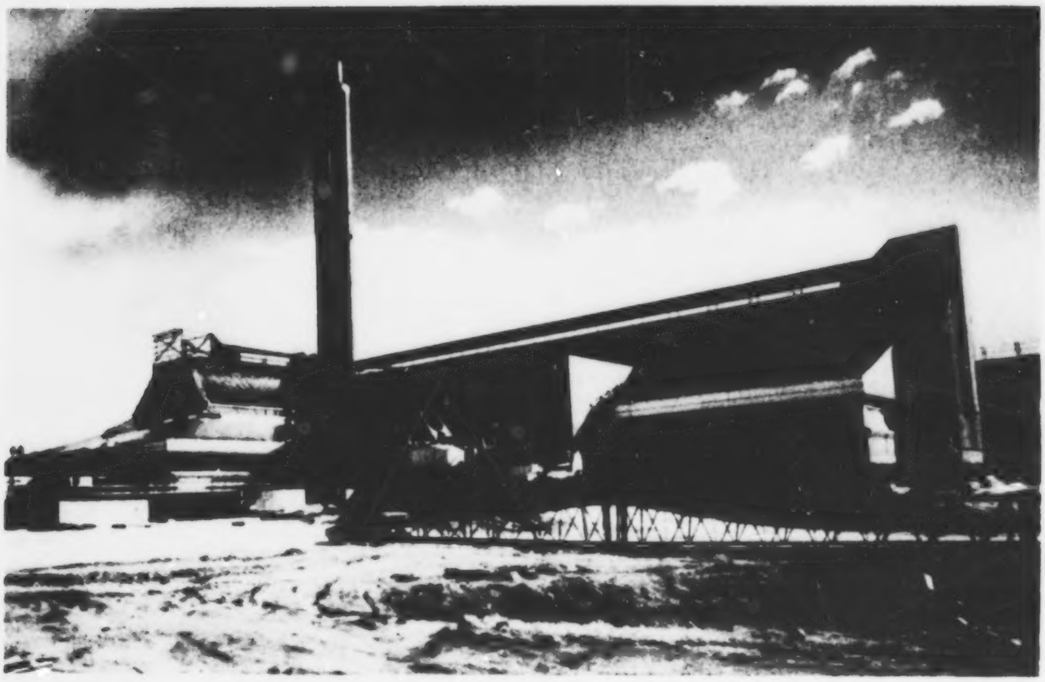
19.44 Based on our examination, and on previous audits of lease purchase projects reported by the Auditor General, it is our opinion that lease purchase is the most costly method for the Department of Public Works to acquire buildings.

Case Study 2

Animal Diseases Research Institute
Lethbridge, Alberta

19.45 The Department of Agriculture conducts research into animal diseases at the Animal Diseases Research Institute near Lethbridge, Alberta. Planning began in 1973 for a new office-laboratory complex there, but approval to construct was not given until 1984.

19.46 The justification in 1974 for the new complex was based on the need to replace obsolete facilities, increases in the scope of scientific research on animal diseases and the results of a "make or buy" analysis. However, neither the requirements necessary to respond to industry demand nor the proposed increases in the scope of scientific research were quantified. The Department recognizes the requirement to quantify research levels and will do so for future projects.



The Department of Agriculture Animal Disease Research Institute, Lethbridge, Alberta (see paragraph 19.45).

19.47 The Department requested approval in 1984 to build the complex, following a re-examination in 1982 of its needs, specifically to develop safety procedures for research in hazardous diseases. A new definition of the safety requirements resulted in some of the previous work by consultants, for which DPW had paid $336,000, not being used. We calculate that the value of the work that could not be used amounted to about $155,000.

19.48 We noted that the amount of usable space in the building is 91 per cent higher than that originally proposed in 1974. In our opinion, there should be a substantiated relationship between staff size, biotechnology developments and usable space, but we found no evidence to demonstrate this. We also found no justification for the proposed increase in staff of 18 person-years, particularly since the Department of Agriculture had (in 1987) indicated subsequently that "no growth was planned for this project". Part of this problem can be traced to the length of the planning phase.

19.49 We were informed by the Department that alternative locations for meeting program needs had been examined; however, our audit showed that the detailed analysis of options had been restricted to alternatives in the Lethbridge area, although this location had not been one of the requirements identified in the needs analysis. Thus we cannot be assured that the alternative adopted was in fact the most economic available.

19.50 The building's gross area was approved by the Treasury Board at 7,027 square metres. The actual gross area as designed is 10,251 square metres. Both Agriculture and DPW agree that there is a discrepancy in the gross area between what was built and what was approved by Treasury Board. In our opinion, the building as designed and constructed is larger than would have been required solely to meet Agriculture's operational needs.

19.51 The Department of Agriculture has indicated that it relied on advice from consultants engaged by DPW to design the building, and that design problems arose because the building was the first of its kind in Canada and expertise was not available to deal with the specialized nature of the facility. DPW points out that Agriculture reviewed and approved each stage of the project, to the completion of working drawings. Agriculture advises that its approval was restricted to operational/functional requirements and suggests that the gross area of the structure exceeds construction norms because they were based on outdated and inadequate standards for biohazardous containment facilities. In the light of these developments, we suggest that the two departments should revise and mutually agree on definitions and standards before undertaking another capital project involving specialized research facilities with safety requirements.

19.52 Insufficient consideration was given to life cycle costs in selecting environmental controls. Although the capital cost of the control system selected was lower than for other bids, if the life cycle costs as identified by the bidders had also been considered, another system that offered a more economical overall cost might have been chosen.

19.53 The design finally approved by the two departments resulted in a building that failed to meet all the Department of Agriculture's requirements for containment. At the time of our audit DPW said they did not have reference to the complete containment standards. Furthermore, with a planning period of ten years or more it would be reasonable to expect that rapid and major changes in technology would affect the design of a complex facility. Accordingly, we believe that a ten-year planning cycle was far too long. We also believe that, although the completed building remains within the net area and total costs approved by Treasury Board, it is not as efficient as it could have been.

19.54 Agriculture has indicated that its concerns were satisfied so long as the building met functional and operational requirements and costs were within the limits approved by Treasury Board. DPW points out that a more efficient design might have been adopted, but is not prepared to state by how much the capital cost might have been reduced, without a complete technical audit. We conclude that a reduction in life cycle costs might have been achieved with a more efficient design. Based on the Treasury Board submission and the gross area of the completed building, we estimate that this reduction could have been as much as $350,000 a year.

Case Study 3

Proposed Animal Virus Laboratory
Department of Agriculture

Background

19.55 The Department of Agriculture proposed building an Animal Virus Laboratory that would replace not only an older Virus Laboratory and Animal Isolation unit in Hull but also an isolated Animal Holding site at Grosse Ile. The Department considered its present facilities dangerously inadequate for laboratory operations and animal quarantine.

19.56 The Laboratory was to be constructed as a necessary ancillary to the present Animal Diseases Research Institute in Nepean. The stated requirement for the laboratory was based on the severe economic impact that foreign diseases could have on Canada's livestock and poultry industries and export markets, and on the continuing need to keep Canadian veterinarians constantly up to date on the symptomatic effects of these diseases.

19.57 The project, whose concept was approved by Treasury Board in 1974, was approved in principle in February 1980, provided that the cost would not exceed $36.3 million. It was also understood that the overall costs of the facility were to be kept at a minimum while ensuring proper safety features.

19.58 The Department of Public Works was directed by Treasury Board to commence the design and development work in 1982-83 and to identify the funds needed for construction. Initial funds of $56.4 million (the original $36.3 million adjusted for inflation) were set aside for the laboratory. Subsequent approval for funding and development of Class "A" estimates was given by Treasury Board in September 1983, with the understanding that construction would be completed in 1987-88.

19.59 **Needs Definition.** We did not find any documents indicating that a thorough needs definition had been carried out to support the Department of Agriculture's contention that, without the laboratory, foreign diseases could have a significant and serious economic impact on Canada's livestock and poultry industries and on world export markets.

19.60 A biohazard security report prepared in 1987 pointed out that, at that time, the Hull Animal Virus Laboratory, where diagnosis and research on foreign viral diseases is conducted, met the necessary medical standards for biohazard security levels.

19.61 **Options analysis.** In 1977 only an analysis for construction or purchase of existing facilities was submitted, for review by both the Treasury Board and the Ministry of State for Science and Technology. This was three years before the laboratory project was approved in principle and five years before it was approved for design. The analysis, which should have been updated because of the laboratory's complexity and changing technology, was more a statement of diagnostic and research concerns than an options analysis identifying alternatives, and evaluating risks, costs, and potential constraints. Evidence of a thorough options analysis could not be found.

19.62 **Contracting for design.** A design consultant, engineering consultant and laboratory consultant were appointed in 1981, about 19 months prior to Treasury Board authorization, without formal competitions, contrary to the Government Contract Regulations. DPW informed Treasury Board of the appointments, but did not obtain approval to by-pass the regulations. We found no evidence to indicate how the consultants were evaluated and rated by DPW to determine their architectural and engineering capabilities.

19.63 **Concept design.** The highly specialized and technical nature of the proposed laboratory required a fully co-ordinated design process to properly define and address its many complex requirements, and to identify costs. The Department of Agriculture's Scientific Committee and Facilities Management Group served as members of the project team.

19.64 Problems occurred in 1983 between the Department's committee and DPW's project manager and design consultant. Meetings took place without scientific representation on matters that needed the Department of Agriculture's approval. Agriculture officials stated that there was no discrete planning schedule to indicate projected dates for completion stages where they would become involved, and what requirements were expected of them. DPW has stated that it kept Agriculture fully informed. In our view the Department of Agriculture's concerns were not being considered as fully as they should have been under a normal client-agent relationship.

19.65 Agriculture officials stated that, following a project briefing by the Department of Public Works, they decided that the project's capital and maintenance costs were beyond their Department's financial capability. At that time the estimated cost of the proposed laboratory, with projected market based charges for DPW services, was $92.9 million. As a result, Agriculture has since developed alternatives to the proposed laboratory.

19.66 In October 1986 Agriculture asked Treasury Board to withhold construction approval of the proposed laboratory for a period of three years until it was able to conduct a review of its program requirements and the laboratory's related design.

19.67 In April 1987 the Department of Agriculture approved $100,000 for a study to evaluate interim solutions and to:

> "identify a temporary alternative to the new Virus Lab and prepare a shelf ready package of a magnitude we could handle. This should be done so that we are prepared to fast-track the project should money become available .... The Branch should look at alternate locations outside Ottawa that would be more acceptable ...."

19.68 The difficulties in planning and co-ordination, along with the proposed laboratory's complex and specialized design requirements, led to the development of a laboratory design that now far exceeds what Agriculture had intended in the way of an affordable facility.

19.69 The Department of Agriculture states that the need for the proposed laboratory remains as strong and vital as at the outset, and is pursuing alternative options for construction.

19.70 The Department of Public Works has paid $4.8 million from its Accommodation Capital Program for plans and specifications for a unique Animal Virus Laboratory. In our view, these plans and specifications cannot be used because the Department of Agriculture is unable to finance the project and proposes to scale down the facility. We are aware that the design consultant has claimed that additional work had been performed, amounting to $735,000. DPW is in the process of negotiating the claim.

SPECIAL AIR SERVICES

Introduction

19.71 Government departments are frequently faced with the need for non-scheduled air services in order to achieve program objectives.

19.72 These services may be obtained by acquiring and operating aircraft for purposes not met by commercial carriers; for example, when aircraft have to be substantially altered to install special equipment and instruments for testing under research and development projects or for sensing and recording geophysical and other data. In other cases, chartered aircraft are used in areas not served by regular commercial routes or where location and timing are essential; for example, to support field parties carrying out research or survey work in remote regions or in hostile environments, such as those encountered in fighting forest fires.

Scope

19.73 We reviewed the management and use of aircraft in seven government departments that spent $55.7 million on aircraft acquisitions, operations, and repairs and maintenance in 1986-87. This involved 55 Crown-owned aircraft and 534 charters or leases arranged by the Department of Supply and Services.

19.74 We excluded the Department of National Defence because its use of aircraft for other than military purposes had been examined recently. The Department of Transport was excluded because it was conducting an internal evaluation of the use of aircraft in its fleet. Our audit included an examination of:

- the existence and use of appropriate management procedures and controls;
- compliance with authority;
- identification of needs and their links to approved program objectives;
- co-operative use of aircraft; and
- maintenance and safety programs.

19.75 In each of the seven departments we examined documents and interviewed appropriate officials. We also visited operation and maintenance centres. In the Department of Supply and Services, we reviewed project files and reports.

Observations

19.76 Treasury Board has issued directives and policies that Departments are expected to follow in managing government projects. Also, the Department of Transport (DOT) has laid down strict operating standards and licensing requirements to ensure that aircraft are maintained in a safe condition by qualified aircraft engineers and are flown by qualified pilots.

19.77 Our audit found that the policies, directives and regulations in effect were followed and that the use of aircraft for special air services was clearly linked to approved program objectives.

19.78 However, there are no government-wide directives or guidelines and, in all but one case, no departmental directives or guidelines, covering the management of aircraft, nor any requirement for uniform basic cost information for major users of aircraft, to properly budget and account for aircraft services.

19.79 The existence and use of appropriate directives and guidelines, which we believe are essential to basic management and control, would contribute to a more economical and efficient use of aircraft by departments.

19.80 These would incorporate the requirements of the new Air Transport Regulations governing prescribed public liability insurance coverage for passengers and would cover such matters as accounting and reporting procedures and recovery of costs from other agencies and persons.

19.81 The charter or lease contract requisition section of the procedures guidelines would include complete details of the required services so that the contracting authority could obtain all of the features required by the user.

19.82 The contracts we examined that were initiated by the Department of Supply and Services (DSS) on behalf of departments, for the lease or charter of aircraft, were comprehensive. They included all the items specified in the departmental mission statements for the planned use of aircraft. We are satisfied that major contracts were awarded only after completion of competitive bidding. We noted that there is no legislative requirement for departments to use DSS to acquire aircraft services.

19.83 We examined the needs analysis conducted by user departments supporting the acquisition of each aircraft or special aircraft service. We found that the needs were clearly expressed and linked to approved program objectives. However, we found distinct weaknesses when we looked at the subsequent planning stage, including options analysis, determination of pricing and availability, and final definition of the project. The most common fault was the lack of in-depth economic analysis in support of the final decision to buy, lease or charter aircraft. It is possible that the decisions were the best in the circumstances but this can not be determined in the absence of appropriate cost analyses.

19.84 We noted one case where a helicopter was chartered at a cost of $3.7 million for surveillance at sea. The charter was entered into without consulting DND, which has relevant experience in a similar operating environment. The helicopter has so far not met the stated primary operational requirements for which it was acquired.

19.85 The acquisition of aircraft followed approved procedures. But several aircraft were acquired under lease-purchase arrangements that ultimately cost more than outright purchase. This could be reduced or eliminated in the planning stage through cost-benefit analysis and the preparation of comprehensive project definitions.

19.86 One of the five entities that own aircraft, the Department of Energy, Mines and Resources, has elected to contract the flying and maintenance of its three aircraft to approved commercial operators through competitive contract arrangements.

19.87 The other departments maintain and fly their aircraft with their own personnel. In all cases we found acceptable compliance with DOT regulations in terms of pilot licensing, aircraft inspections and maintenance, and the maintenance of appropriate log books and other records.

19.88 Increasing complexity of aircraft design and construction puts a burden on operators to maintain accurate records on the status of critical components and assemblies that are subject to periodic inspections and scheduled maintenance or replacement. We found that this was accomplished in all cases but that one group had reached the limit of its capacity to do so manually. We observed that operation and maintenance manuals were adequate and that appropriate training and safety procedures were in place.

19.89 We were satisfied with the contracting procedures used in acquiring chartered air services. However, we noted that the procedures for requisitioning chartered air services by user departments could be improved by standardizing the procedures and issuing guidelines to govern the process.

19.90 In cases where several short-term charters by user departments were involved, we observed that opportunities to improve bargaining power were lost by not grouping contracts.

Departmental Observations

Department of Fisheries and Oceans

19.91 The Department of Fisheries and Oceans (DFO) requires a mix of ships and aircraft to carry out its fishery surveillance and regulatory enforcement responsibilities. In 1987, DFO was given authority to charter a fixed wing aircraft, Beechcraft King Air B-200, and a helicopter, MBB BO-105, to meet these responsibilities within Canada's 200-mile fishing limit off Newfoundland.

19.92 The Department uses its own and chartered vessels for surface surveillance, but also relies on aircraft provided by the Department of National Defence and on chartered aircraft for aerial surveillance of the fisheries. Additional assistance from the Department of National Defence can be obtained at a cost established between the two departments by a memorandum of understanding.

19.93 Performance specifications for the surveillance and regulatory enforcement activities were established in a report that was prepared in 1981 but that relied on data from 1977, 1978 and 1979. These performance specifications have not been revised even though the data on which they are based are now nearly 10 years old. Moreover, the report was based on the faulty assumption that fishing vessels are randomly distributed over the entire fishing area rather than concentrated in specific areas.

19.94 **Fixed wing aircraft.** In acquiring the Beechcraft, the Department responded to an unsolicited proposal from a commercial operator who offered, in addition to the use of the aircraft, the use of a very sophisticated search radar system.

19.95 The Department has determined that the cost effectiveness of the Beechcraft, operating from St. Johns, Newfoundland, is four times greater than the Tracker aircraft supplied by the Department of National Defence (DND) for the equivalent search capability. It should be noted that, although DND has a mandate for fisheries patrols, this is not the primary mission of DND aircraft.

19.96 **Helicopter.** In seeking approval to acquire a specific helicopter, DFO proposed to ultimately enhance its capability for conducting surveillance and regulatory enforcement duties at sea, up to 200 miles off Newfoundland. In preparing the justification for the three-year trial project, the Department developed tasks but relied on the stated mission profile of the helicopter used by the Canadian Coast Guard. The Department did not develop its own unique mission profile for the aircraft, although its role will differ significantly from that of the Coast Guard.

19.97 The helicopter has been chartered for the project at a cost of $3.7 million.

19.98 In analyzing the possible operation of the helicopter for use off Newfoundland, DFO did not examine DND's experience in helicopter operations off ships of comparable size. Had the Department done so it would have been able to consider operational limits that could affect helicopter operations at sea, before it decided to acquire the equipment. Senior management cannot be sure, therefore, that this aircraft will be cost effective in its proposed offshore role, or that it will meet the Department's operational requirements.

19.99 The helicopter is limited to Visual Flight Rules (VFR) and to operations under free deck landing conditions. These depend in turn on favourable sea conditions which, based on observations over several years, can be expected for less than about one third of the time the ships would be at sea. As long as the helicopter is limited to VFR and free deck landing conditions, we calculate its cost effectiveness at less than 10 percent of other options, such as a combination of existing ships and fixed wing aircraft charters available to the Department.

Department of Agriculture

19.100 Agriculture owns a Cessna 188 aircraft, bought in 1981, operated and maintained by the Forest Pest Management Institute in Sault Ste. Marie for evaluating pest control materials and developing suitable spraying techniques.

19.101 In addition to flying and maintaining the aircraft, a licensed Technician/Pilot changes or modifies the atomization system, conducts spraying trials, and otherwise fills a full-time position in support of the Institute's program.

19.102 The spraying season extends from early May to late September. Much of the time is spent preparing equipment, ferrying the aircraft from one research site to another, waiting for suitable weather conditions, and waiting for the appropriate stage in the pests' life cycles. These circumstances, and the need to ensure that spraying equipment is purged of all materials used in previous applications, are given as the reasons for not continuing to use chartered air services.

19.103 The aircraft's logbook shows that flying time for the aircraft was only 38 hours in 1984-85, 21 hours in 1985-86, and 30 hours in 1986-87.

19.104 The St. Jean Research Station of the Department of Agriculture has made an arrangement with the National Aeronautical Establishment (NAE) Division of the National Research Council to carry out an experimental spraying program. We believe that the Department should investigate the possibility of combining its spray program with that of NAE so that the Cessna could then be available for other projects.

Department of Energy, Mines and Resources

19.105 The Department owns and operates three aircraft:

- a Convair CV-580 controlled by the Data Acquisition Division of the Canada Centre for Remote Sensing;
- a Short Skyvan controlled by the Exploration Geophysics Subdivision of the Continental Geoscience and Mineral Resources Branch; and
- a Beechcraft Queenair controlled by the Geophysics Division and used for airborne geomagnetic surveying.

19.106 The three aircraft are flown and maintained under a contract arrangement with an approved operator.

19.107 The three aircraft now owned by EMR were acquired in accordance with approved procedures, and satisfy clearly defined program objectives. The decision to purchase instead of chartering was based on such factors as the need to modify the aircraft to accept some of the required equipment and to make them suitable for the use of new ultra-sensitive sensors.

19.108 However, we found no evidence of in-depth economic analyses to support the decisions to buy instead of leasing.

19.109 Some of the aircraft services used by EMR are required to satisfy continuing co-operative agreements between the Department and various provinces and with sectors of private industry.

19.110 The Department employs aircraft indirectly when it places contracts with firms in the private sector to carry out surveys, prepare maps and perform other such tasks. Contracts are awarded after a competitive bidding process.

19.111 In addition, the Department makes heavy use of chartered air services. The biggest user of chartered aircraft within EMR is the Polar Continental Shelf Project (PCSP) which uses up to 21 rotary wing aircraft and three fixed wing aircraft under three-year leasing contracts. It also uses other aircraft on short-term contract when required.

19.112 The PCSP was established in 1958 to conduct scientific studies in the Canadian Arctic (specifically the Arctic Islands and Arctic Ocean) and to assist other groups carrying out similar work. Since then the emphasis has shifted to providing logistic support to government and private sector scientists who carry out scientific research and surveys in the designated area. A new mandate reflecting this type of operation was approved in June 1986.

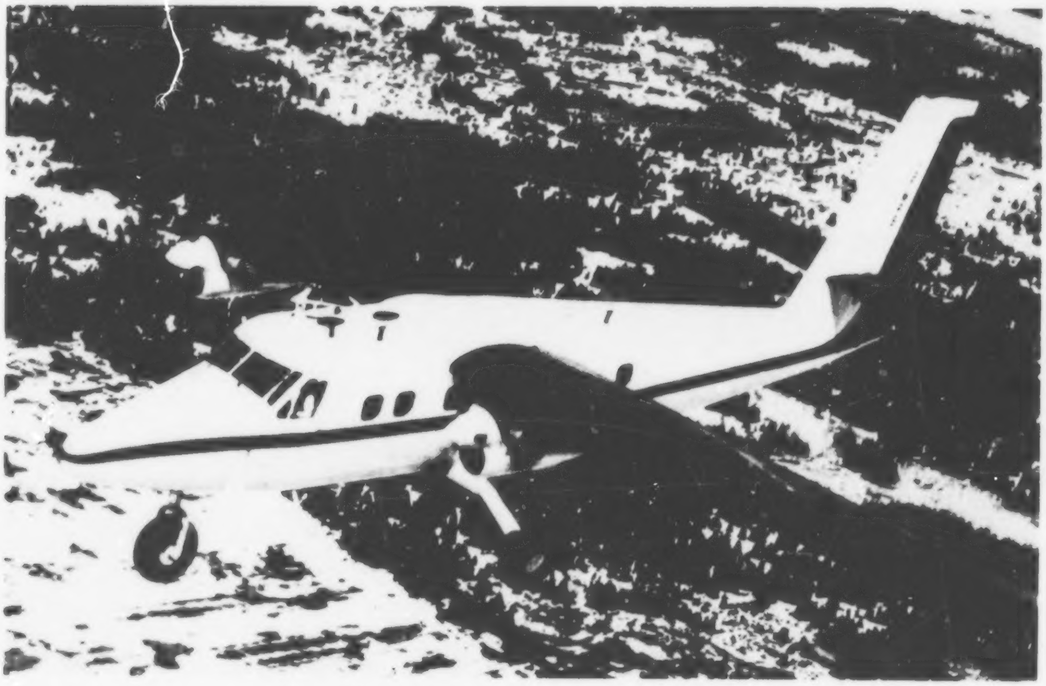
19.113 PCSP provided logistic support for 221 field parties during 1987-88. Expenditure for that year was about $7.45 million, of which $2.36 million was recovered from users of the service. The season's flying amounted to 5,600 hours for helicopters and 2,500 hours for fixed wing aircraft.

19.114 We found no cost benefit analysis to support the decision to lease instead of purchasing aircraft.

Royal Canadian Mounted Police

19.115 At the time of our review the RCMP operated 32 aircraft.

19.116 The planning for acquisition of aircraft by the RCMP is integrated into the overall capital acquisition planning process. There is a five-year program for replacing aircraft and



Twin otter operated by the RCMP supporting both provincial and national policing requirements (see paragraph 19.116).

acquiring new aircraft, in response to needs for operational duties developed by headquarters or to support operational needs expressed by the provinces with whom the Force has Provincial Policing Agreements. In the latter case, the acquisition or replacement cost is shared by the province in accordance with the terms of the Provincial Policing Agreement.

19.117 Aircraft use is governed by operational needs. Generally these needs include:

- transport of investigative personnel;
- aerial searches;
- transport of prisoners;
- transport of Crown witnesses;
- transport of officers and personnel, including contractors, to isolated posts for inspections, repairs and other duties;
- transport of dependents to and from isolated posts for rest and recreation and medical reasons; and
- transport of freight.

19.118 Flight operations returns are filed monthly by each local air service and cover all aircraft and all flights. We reviewed these returns for all aircraft for a two-month period of 1987 and we found them to be in order. We did note, however, that in this period, the RCMP carried approximately 4,200 non-RCMP individuals, including approximately 1,500 prisoners and 1,600 dependants. The other passengers were members of other forces, government departments or contractors. Based on this two-month sample, RCMP aircraft carry approximately 25,000 non-RCMP passengers per year.

19.119 The transport of non-RCMP personnel is governed by operations policy and procedures that are, for the most part, satisfactory. We did, however, have two areas of concern.

19.120 We noted that, on occasion, non-accompanied dependants were carried. According to government policy, such persons may be authorized to travel only when "approved by the deputy head of department or head of agency". At present such travel is authorized by the division Commanding Officer or his representative. We believe there is a need for the RCMP to review its policy on the transport of non-member personnel and arrange for the delegation of authority for the approval of such transport to appropriate levels.

19.121 We also noted that the RCMP has a policy of cost recovery for transporting personnel for other government departments. This policy is not enforced since it is difficult or impossible to separate out costs of services associated with such transport. Here again, we believe the RCMP would be well advised to review its policy on cost recovery with respect to the benefits and costs of its application in the case of air services. It could also investigate the possibility of applying the cost recovery policy based on standard charges by aircraft type.

19.122 Given such a system we believe approximately $200,000 could be recovered from presently non-paying passengers.

19,123 The RCMP carries out its own scheduled major maintenance at Department of Transport facilities in Ottawa. At one time the RCMP contracted maintenance to commercial contractors. A comparison of costs was made on the basis of major inspections of Twin Otters. Commercial contracts were priced at approximately $80,000. The cost of similar work done in-house by available staff, including the cost of labour, parts and supplies, was approximately $39,800.

19.124 We reviewed the RCMP maintenance manuals and practices. We found them to be complete and to cover all normal maintenance procedures. However, we had one concern in the area of maintenance scheduling. As aircraft become more complex, there are steadily increasing numbers of parts and sub-systems that must be inspected, maintained or replaced, based on hours of operation, cycles, calendar date or other factors. Thus the aircraft operator must keep track of the usage of not only the aircraft, but also critical parts and sub-systems. This is currently done manually by each detachment. There is no central overview except on overall use of aircraft and engines. We believe that, as an additional safety measure, the RCMP could consider using a central computer-based system for tracking aircraft and component use.

19.125 Inventories of spare parts are based on usage and are kept to a minimum. In essence, reliance is placed on manufacturers to carry inventory, and the RCMP stocks only enough to meet requirements during reprovisioning lead time.

19.126 In order to accommodate resupply, the RCMP has approximately 40 contracts for the repair and overhaul of repairable parts and approximately 40 standing offer contracts for the supply of consumable parts.

19.127 The inventory consists of about 4,800 line items with a value of approximately $2 million. The inventory system is manual (on cards).

19.128 Although the manual system operates well and ensures that parts are available while minimizing holdings, it is at the limit of what can reasonably be maintained by the staff who use it. We believe that there are commercially available software packages that would enable the RCMP to carry out these inventory control functions more efficiently.

National Research Council

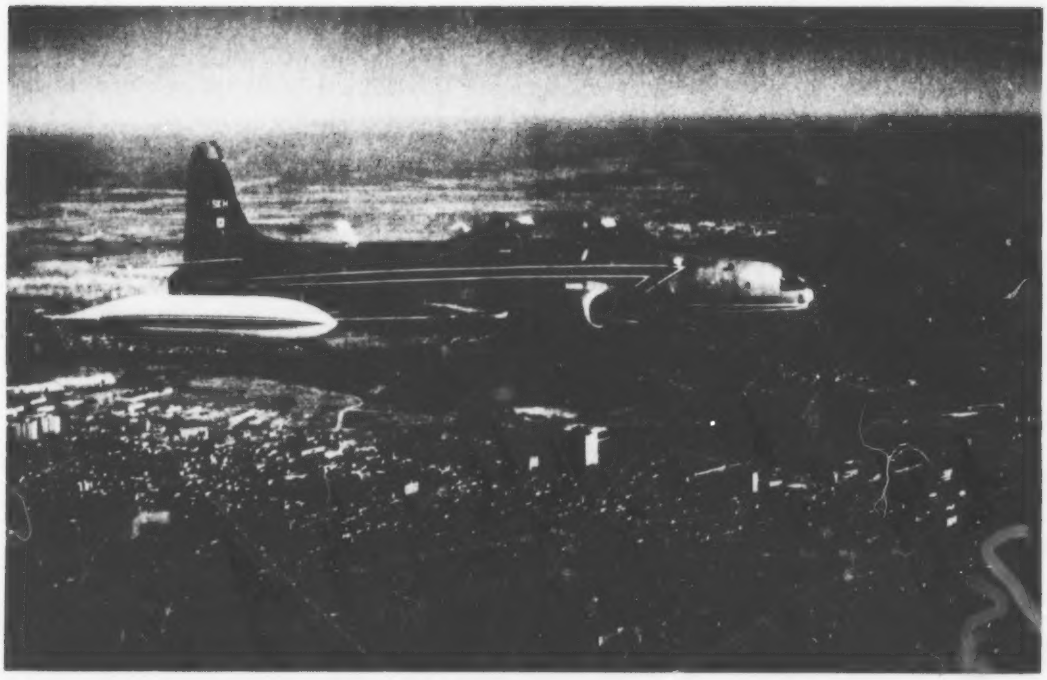
19.129 The nine aircraft owned by NRC are operated by the Flight Research Laboratory (FRL) of the National Aeronautics Establishment. The FRL has a mandate to undertake flight mechanics research, flight systems technology development and various airborne scientific studies.

19.130 The research and development projects are, in general, collaborative undertakings with partners from industry or from other government agencies. They involve joint scientific teams, applications of a flight facility and joint funding arrangements that generate income for NRC.

19.131 All aircraft are used to carry out scientific investigations and are therefore variously equipped with instrumentation to sense and record the required data. Pilots and engineers co-operate in designing the installation of equipment and in maintaining aircraft configuration for operational and safety purposes.

19.132 We found that overall control of the facility operation was sound. All manuals governing flying operations and maintenance are complete and appropriate. Training and safety procedures are also complete and adequate for their purpose.

19.133 In our examination of the maintenance function we found, with two exceptions, a well-organized and controlled operation that could serve as a model for the operation of small air fleets where several different makes and types of aircraft are employed.



National Research Council T-33 used for high altitude research projects. NRC operates a fleet of aircraft in support of scientific research (see paragraph 19.129).

19.134 The heart of the system is a program run through a network of three micro-computers. Reports show the status of each aircraft in terms of hours remaining before inspection, maintenance or replacement of all affected components and assemblies.

19.135 We noted that the financial information system does not provide information in a form that permits the ready accumulation of costs per aircraft, since the system focusses on specific projects. Therefore, true costs of aircraft operation and maintenance are not available for performance evaluation of each aircraft. This shortcoming is being addressed through the planned use of a micro-computer.

19.136 An accurate figure for the value of the spare parts inventory is not available. Some work has been done to improve the appropriate section of the central NRC inventory system but the figures are still unreliable. However, the data base of the maintenance control system is being expanded to provide, sometime in the future, the value of the inventory in total and by category.

19.137 Chartered aircraft are also used in NRC by the Institute for Research in Construction, the Atlantic Research Laboratory and the Astronaut Program Office of the Space Division.

19.138 We are satisfied that the use of chartered aircraft by NRC is reasonable, appropriate and linked to approved program objectives. Where possible, use is made of aircraft operated by other departments; one example of this is NRC's participation in the Polar Continental Shelf Project of Energy, Mines and Resources.

Department of the Environment

19.139 The Department uses aircraft within the Canadian Parks Service and Environmental Services Program.

19.140 The Canadian Parks Service leases and charters its aircraft by departmental contracts, by Department of Supply and Services contracts and by individual regional standing offer agreements. It does not own aircraft. The majority of lease and charter aircraft services are acquired by regional organizations through DSS's Surveys and Air Services Group in Hull, Quebec. This group offers expertise in aviation needs and contracting requirements.

19.141 Standing offers are used instead of contracts when aircraft are needed on an "as-and-when-requested" basis and for short periods. The period for a standing offer is generally limited to one year. The disadvantage of a standing offer is that the carrier can withdraw at any time without legal recourse by the Department.

19.142 In addition to requisitioning aircraft service requirements through the Surveys and Air Services Group, the Regional Offices occasionally lease and charter aircraft directly by inviting tenders for certain projects.

19.143 The Canadian Parks Service uses aircraft for fire suppression and fire-fighting; animal and wildlife surveys; search and rescue operations; aerial monitoring of wildlife regulations; smoke and law enforcement patrols; park boundary patrols; and a variety of other tasks incidental to parks management.

19.144 Each Region defines its aircraft service requirements based on past satisfactory operating experience, cost, suitability of aircraft, and local availability of carriers.

19.145 Aircraft management is delegated to field personnel who manage their aircraft service requirements more or less independently on site.

19.146 Each Region is restricted in its opportunities for realizing economies through co-ordination of aircraft, by the diversity of tasks, availability of licenced carriers, and limitations imposed by the base protection provisions of the new Air Transport Regulations.

19.147 The Wood Buffalo National Park produces an annual Seasonal Forest Fire Report showing the distribution of hours, by contract helicopter and fixed wing aircraft, used for fire control and park operations. The contract, utilization, maintenance and standby costs of individual aircraft are not reported and this makes it difficult to determine if the aircraft are cost effective and used in the most efficient and economical way for fire suppression and control. Also, this Region has not examined the economic viability of using more modern fire-fighting aircraft with bigger payloads, to determine which is most cost effective.

19.148 Regional use of aircraft services for parks has not been evaluated or audited by the Department's Internal Audit Branch. In our view, a periodic review and evaluation of the Department's use of aircraft services on a global scale would be of benefit to senior managers and users of aircraft services.

Department of Indian Affairs and Northern Development

19.149 DIAND does not own any aircraft but makes extensive use of chartered air services. The reported cost of these services was $20.4 million during the 1986-87 fiscal year. The services were used to transport people and goods between remote areas, to transport sick and injured people to hospitals, and to investigate smoke and fire hazards.

19.150 We observed that the Department has established an appropriate system and procedures to prepare requisitions for contracts and standing offer agreements. In our view the system could be modified to include the new Air Transportation Regulations, managerial responsibilities and the circumstances under which air services may be acquired.

MULTIPLE SOURCE SUBSIDIES

Background

19.151 The federal government has a number of programs that offer grants or contributions as incentives to businesses or individuals, to accomplish social, economic or cultural policy objectives. These programs may overlap as to the types of projects that are eligible to be funded by them. For example, an applicant might be eligible for a combination of funding from various departments for research, plant and equipment, international marketing or employee training.

19.152 In this audit, our objective was to assess whether there is a significant risk that projects may be funded under more than one government program, without the knowledge of other donor departments or in contravention of government policies. We assumed that any department funding a project should be aware of other government funding for the same project when deciding on the level of assistance to be provided or when paying for costs incurred by the project.

Scope

19.153 We concentrated on programs aimed at supporting commercial enterprises such as those normally funded by the Department of Regional and Industrial Expansion (DRIE) and the National Research Council (NRC), rather than on social development programs. Using data in the Public Accounts of Canada, we identified recipients of payments from two or more federal government departments. From this list we identified 38 recipients who had received at least one contribution from NRC or DRIE.

19.154 Our observations are based on a sample of 21 of these. We reviewed 114 contributions to these recipients, administered by eight departments. The total authorized amount of these contributions was $55.3 million.

Observations and Recommendations

19.155 We found that five of the recipients had received contributions from more than one department for the same or closely related projects. In three of the five cases, we observed that the two donor departments were unaware that they were both funding closely related research and development projects or parts of the same project. There was no indication that the departments involved had shared specific information on costs claimed. File documentation, for the most part, was insufficient to permit us to determine whether the same project costs were paid for by both departments. However, we did find double funding of some minor costs in one of the three cases, which involved a research and development project funded simultaneously by NRC and DRIE for new sawmilling techniques. We found that the recipient had claimed consulting costs from both departments, totalling $7,130. The departments were unaware of this overlap in funding. When we brought this to DRIE's attention, the Department took recovery action.

Conclusion

19.156 In those projects funded by more than one department, communication among the funding departments was weak and the risk of double funding was present.

19.157 Departments with related programs, where grants or contributions are used in delivering the programs, should communicate with each other as to whom they are funding and the nature of the projects. If departments then become aware that they may be funding the same or similar work, they should exchange information on claims for payment to ensure that no unplanned double funding occurs.

FOLLOW-UP OF RECOMMENDATIONS IN PREVIOUS REPORTS

FOLLOW-UP OF RECOMMENDATIONS IN PREVIOUS REPORTS

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FOLLOW-UP OF RECOMMENDATIONS IN PREVIOUS REPORTS

Introduction

20.1 This is the fourth year we have reported on the status of action taken by departments and agencies in response to the Office's observations and recommendations. We believe this follow-up work, which generally occurs two years after the original reporting in the annual Report, has been useful in keeping the Public Accounts Committee and Parliament informed about action taken in correcting the deficiencies noted.

20.2 The progress of action taken varies considerably. In some cases considerable progress has been made, while in others little has transpired. At the Canada Employment and Immigration Commission, the programs and organization have changed so dramatically since our 1986 Report that we concluded there was little point in conducting a follow-up.

20.3 The Department of Agriculture's final target date for completing the planned corrective measures in response to our 1986 report was 31 October 1988, so we have deferred the follow-up until 1989. This year we are reporting on follow-up work on four 1985 chapters which had been delayed for similar reasons and one 1984 chapter, which was also followed up in 1986.

20.4 Follow-up reports on the 1986 chapters on Fisheries and Oceans - Pacific and Freshwater Fisheries and Indian Affairs and Northern Development are included after this year's reports on those departments in Chapters 13 and 14 respectively.

SECRETARY OF STATE OF CANADA - CANADA STUDENT LOANS PROGRAM - 1984, CHAPTER 14

Scope and Observations

20.5 Our 1984 audit covered the principal operations of the Secretary of State, including the Canada Student Loans Program. We drew attention to several weaknesses in the management of a project then under way to develop a new information system. In 1986 we followed up on how the system was being implemented and found problems that were causing delays and contributing to increased costs. The Secretary of State assured us, however, that the system would be in operation by the end of 1986.

20.6 The purpose of this follow-up is to trace the progress made since our last report and to assess development costs to date.

20.7 Development of the new information system for the Canada Student Loans Program has been delayed again, for an indefinite period. The design phase started back in 1984 and was contracted out to the private sector as a turnkey system project. A turnkey system project is a well defined system that should be developed, fully tested, installed and implemented with little or no involvement from the user.

20.8 In January 1987, the Secretary of State stopped the project after an investment of seven years and approximately $5 million. The decision was taken when the Department realized that the system being developed could not be implemented as planned without an additional one or two person-years and another $.5 million to $1 million as well as additional maintenance costs beyond initial forecasts. Even then there would be no guarantee of success. According to an internal study, development up to the time of the decision to stop the project had produced a system that was neither reliable nor operationally effective.

20.9 The factors that led to this situation were numerous and their interrelationships complex. The most significant among them:

- The Secretary of State did not assign to the project personnel with the necessary experience to carry out such an ambitious and complex project.
- The Secretary of State did not assign to the project personnel with sufficient experience in managing contracts for systems development. Several of the Department's decisions and actions during the project negated the possibility of delivering a complete turnkey project.
- The Secretary of State did not adequately define in advance the features it wanted in the new system, leading to many changes during the implementation phase. In a few instances, these changes meant that part of the development work had to be redone.
- There was inadequate continuity between the team responsible for the initial conceptual work between 1981 and 1983 and the system design team responsible for the implementation between 1984 and 1986. In addition, most members of the design team were from outside the Department and the implementation phase was also assigned to another external team.
- Communication between users of the system and the implementation development group was ineffective, and relations were strained at times during the project.

New Orientation

20.10 At the beginning of 1987, the Secretary of State reorganized the Canada Student Loans Program and its management team.

20.11 The reorganization added team members to the Program with more experience in the field of finance and in managing large projects.

20.12 The Secretary of State has identified alternative ways to replace the current Student Loans system. The first option considered was the purchase of commercial accounts receivable software. The second option being considered is the use of a commercial integrated off-the-shelf student loans computer system. A third option would be to restructure the current information system and to develop additional programs to improve effectiveness and control.

20.13 We are informed by management that, in addition to the above options, a re-evaluation of the approach and means being used to meet the Program objectives is being undertaken jointly with Treasury Board.

20.14 At present, the Program team is optimistic; solutions have been identified, the Systems Branch has become involved, and potential suppliers are responding to requests for information concerning a commercially available integrated off-the-shelf Student Loans system.

20.15 Given the current state of progress on the search for alternative solutions, we are not in a position to gauge the probable success of the Secretary of State in introducing a reliable and adequately controlled system for the Canada Student Loans Program. At the same time, we note that the new team intends to proceed cautiously so as to avoid repeating past mistakes. It is an approach we cannot but encourage.

PUBLIC SERVICE COMMISSION - 1985, CHAPTER 6

Background

20.16 Our 1985 comprehensive audit of the Public Service Commission (PSC) addressed a number of staffing activities including policy development, delegation of staffing authority, monitoring of operations, and the evaluation and audit of the staffing system. We looked at certain appeals and investigation activities as well as those relating to the Commission's selection standards and tests. We also looked at planning and control methods with respect to language training and administrative activities in staff training and development. Finally, we examined the Commission's administrative planning, review and control mechanisms.

20.17 Our observations resulted in 20 recommendations in the areas of needs analysis, project management, monitoring operations, staffing system evaluation, exclusion approval orders, staffing audit, linguistic services and program planning and evaluation.

20.18 The Public Accounts Committee held three hearings on our Report chapter. In its Tenth Report to the House, tabled in April 1986, the Committee made 13 recommendations to the Government and the PSC.

Scope of Follow-up

20.19 We reviewed the actions taken by the Commission pursuant to our recommendations and those of the Public Accounts Committee. In addition to formal presentations made by management, our follow-up audit included interviews with management and staff, a review of relevant documentation and of reports prepared by the Commission for the Public Accounts Committee. It did not include visits to departments carrying out delegated staffing activities. Accordingly, we cannot fully assess the results of the initiatives introduced by the Commission to deal with these matters.

Overall Conclusion

20.20 The Commission has moved aggressively: of 33 recommendations (13 from the Public Accounts Committee and 20 from our Office) 23 have been implemented, 9 are in the process of being implemented, and the other is no longer applicable.

Summary by Observations

20.21 **Needs analysis.** In 1985 we reported that the Commission had not analyzed the needs and problems the public service encountered in the staffing system. Although the Commission could count on a number of sources of information, we found no centralized mechanism to systematically analyze this information. Since then, several projects have been put into place by the Commission to correct this situation:

- The Commission carried out studies on information needs relating to the staffing process, and covering such areas as definition of existing data sources, data bank and information systems, evaluation of information requirements and definition of a streamlined and simplified information structure.

- Administrative reform projects were completed in several departments to improve the efficiency and effectiveness of current staffing practices within the existing legislative framework. The results of these projects were reported to the Commission and are a useful source of information covering both global and individual needs.

- Organizational changes within the Staffing Branch were made, so as to rationalize and simplify its activities. The data, systems, analysis and monitoring units are presently centralized and "functional". According to the PSC, this should provide for better use of the information collected, allow for global analysis and enable it to report on important staffing issues and needs.

- A consultative sub-committee was created, made up of chiefs of staffing, to provide a means of consulting on staffing policies, programs or studies. This will facilitate participation of users in needs analysis before policies are issued or modified.

- The Commission is presently completing the development of a Staffing System Model to identify managers' decision points in the staffing system and a staffing policy framework to include such things as policy statements, guidelines, and performance indicators.

20.22 **Project management.** In 1985 we found weaknesses in planning and controlling projects relating to policy and program development, administrative reform and delegation of activities.

20.23 During 1987, in response to our observations, the Public Service Commission developed and distributed to all its employees an administrative policy on project planning and control.

20.24 We found that better defined management practices were in place to ensure proper planning and control over projects by the Staffing Branch. The projects we examined were well defined, planned and monitored.

20.25 **Monitoring.** We observed in 1985 that the Commission did not have a monitoring process to provide assurance that staffing policies and practices achieved intended results, were effectively applied, and that delegated authority was being properly exercised.

20.26 In response to our recommendation, the Commission established a Monitoring and Review Unit to monitor departmental staffing activities. Monitoring requirements for Commission staffing policies and procedures are presently being developed.

20.27 **Audit of staffing.** In 1985 we recommended that the Commission clarify its auditing mandate and related audit objectives. We also made recommendations in the following areas:

- completion of directives and guidelines for audit methods, scope and documentation required to support findings;
- adherence to these directives;
- revision of audit files;
- post-audit quality control; and
- training of auditors in audit concepts and techniques.

20.28 In response to our recommendations, the Public Service Commission has clarified its staffing audit mandate and objectives. This is reflected in the Commission's new audit policy dated 29 September 1986, which sets out the roles, responsibilities, scope and objectives of the Audit Branch. As well, the personnel audit agreement between the Treasury Board Secretariat and the PSC was revised in September 1986. This agreement specifies the policies, procedures and systems to be audited by the Commission. Further, the Commission has improved its Estimates Part III to more accurately reflect its audit mandate.

20.29 With respect to the other observations raised in our Report, the Commission has made progress in addressing most of our recommendations. However, because the majority of these initiatives have only recently been taken, and because of the limited extent of their application, we were unable to assess their implementation and results. Our findings are summarized below:

- New guidelines and directives for audit activities delegated by TBS were developed, except for those pertaining to the reliance on departmental internal audits, and were implemented during 1987.
- At the time we completed our review in April 1988, action had not yet been taken with respect to staffing guidelines. These are expected to be developed and in use by the fall of 1988.
- A draft Audit Manual, describing the audit process, methods and work instruments to be used, has recently been developed by the Audit Branch and was being applied for the first time during our review.
- Except for the lack of standard audit programs, significant improvements in file documentation were noted. Their future development will ensure that all audit areas and procedures are covered and applied. It was also noted that file reviews were now being done. However, the timeliness of these reviews needs to be improved.
- Although no action had been taken toward implementing an independent post-audit quality control review process, we have been informed that this process will be fully operational by the end of 1988.
- Finally, during 1987-88, appropriate action was taken toward developing and implementing an Audit Branch training program and plan.

20.30 **Exclusion approval orders.** Section 39 of the Public Service Employment Act permits the Commission, with the approval of the Governor in Council, to exclude persons, positions or classes of positions in whole or in part from the operations of the Act where it is not practicable or in the best interests of the PSC to apply the Act.

20.31 In 1985 we recommended that the Public Service Commission document the factors it takes into account when recommending exclusion approval orders and that it monitor departmental administration of these orders. The Commission has taken corrective measures in this regard.

20.32 In 1986 revised guidelines were issued to departments to outline pertinent information they should provide to the Commission in support of their applications, to ensure that all exclusion approval orders granted are subject to a monitoring process, and to develop a consultation process with unions so that their views and concerns are taken into account.

20.33 Our review of exclusion approval orders granted since the application of these new guidelines revealed that the Commission is now documenting the factors it takes into account in recommending approval by the Governor in Council.

20.34 As previously mentioned, the PSC is still in the process of developing its monitoring requirements for the Staffing Branch. Nevertheless, the Commission is conducting a review and analysis of periodic reports submitted by departments on their administration of individual exclusion approval orders.

20.35 **Linguistic Services**. In 1985 we reported several weaknesses in the Linguistic Services Directorate (now known as the Course Development Directorate). These pertained to setting objectives, assigning priorities and recording project selection criteria, lack of information on requests for services, and project management.

20.36 Our review disclosed that all our recommendations had been addressed and corrective measures taken, except in one case where the observation was no longer applicable.

20.37 **Evaluating the staffing system.** In 1985 we observed that the PSC had little information on the suitability and effectiveness of its policies. This responsibility had been delegated to the Treasury Board Secretariat in 1982, and only two evaluations had been done.

20.38 We recommended that the Commission review the merits of delegating the evaluation of its staffing policies to Treasury Board. An agreement was reached by the two organizations that this activity be repatriated by the PSC.

20.39 **Program planning and evaluation.** We reported in 1985 that the Commission had not yet evaluated any of its programs. We recommended that it finish assembling its program evaluation team and also integrate in its evaluation plan all evaluation activities, including staffing policies.

20.40 We found that the program evaluation function has been operational since 1986 and is fully staffed.

PAC Recommendations

20.41 The Public Accounts Committee in its Tenth Report to Parliament, tabled in April 1986, made a number of recommendations pertaining to the Commission's staffing audit mandate; the simplification of its staffing process; its monitoring of departmental staffing procedures; and the development of guidelines governing the implementation of the reverse order of merit principle. It requested the Commission to make written reports by 30 September 1986 on its progress in implementing its recommendations, as well as those of the Auditor General.

20.42 It further requested, in December 1986, that the Commission report in writing to the Committee by 31 March 1987 and again by 31 March 1988 on its administrative reform project and on the audit of staffing.

20.43 Our follow-up review disclosed that the Commission had submitted on a timely basis the progress reports requested by the Public Accounts Committee. Action had been taken on all recommendations, and improvements were evident in several areas.

CUSTOMS CANADA - 1985, CHAPTER 7

Introduction

20.44 In our 1985 Report chapter on the audit of Customs Canada, we focussed on the operational activities in Customs Ports and reviewed systems and procedures that were in direct support of Customs' operational activities. The chapter also addressed some departmental management principles that affected overall operations.

20.45 Over the past three years there have been several major initiatives that have affected or will affect the Department – revision of the Customs Act, implementation of the Harmonized System and signing of the free trade agreement – but none of these has had a direct impact on our 1985 recommendations.

20.46 In January 1988, the Customs Commercial System was implemented nation-wide, and it is relevant to three of the eight recommendations on which we are reporting.

20.47 Our follow-up findings, based on a review of departmental activities to March 1988, are summarized below according to the categories in which they were originally reported. The references are to the 1985 chapter paragraphs.

Conversion of Interdepartmental Agreements into Operating Procedures

> 7.44 The Department should intensify its review of the consistency with which directives are being applied in the field, and it should take corrective action where indicated.

20.48 We noted that the Department is addressing the uniformity of application of directives by focussing on two elements – administration and legislation.

20.49 Within the administrative area, regular regional and headquarters audits, as well as the Operational Compliance Check System, provide procedures for administering directives in a consistent manner.

20.50 Within the legislative area, the Department's directives do not permit any professional judgment or interpretation. However, because of environmental circumstances, Customs Inspectors do apply judgment in carrying out some of these directives. The Department has some mechanisms for reviewing the consistency with which these directives are being applied, but they still need to be improved.

Facilitating and Controlling the Entry of International Travellers

> 7.78 The Department should monitor the application of instructions on the roles of enforcement and facilitation to determine if the intended results are being achieved.

20.51 In 1985 we noted that Customs Inspectors were uncertain as to the appropriate balance between facilitating the entry of travellers and enforcing the various statutes. Uncertainty therefore existed about the role that Inspectors were required to fulfil when processing passengers.

20.52 The Department has established mechanisms to ensure that employees are aware of, and understand, the significance of achieving a functional balance between facilitation and enforcement. This concept is disseminated through formal training, ongoing monitoring and personnel appraisals.

20.53 In addition, the Department has modified its enforcement strategies in an effort to provide Inspectors with a means of focussing their attention on higher risk travellers. In adopting this approach, the Department intends to facilitate the processing of passengers complying with the law.

20.54 Both the mechanisms and the updated enforcement strategies give the Department an improved ability to convey to Customs Inspectors its philosophy and to provide them with a practical means of achieving the appropriate balance between facilitation and enforcement.

Facilitating and Controlling Commercial Imports

20.55 Three recommendations made in our 1985 Report relate to the new Customs Commercial System (CCS) and are addressed below.

> 7.88 The Department should ensure that unmatched Cargo Control Documents are properly acquitted, and that proper supervision is maintained over the process.

20.56 The acquittal process, which matched entry documents with accounting documents, was an important control for ensuring completeness of revenue collection. To provide better control over revenue collection, the Department has introduced an Overdue Release Report and has transferred responsibility for payment from the carrier to the importer.

> 7.101 The Department should, as soon as practical, establish a formal system to identify and select high-risk shipments, and a statistically valid selection system to measure the compliance rate of importers.

20.57 The CCS provides a formal, on-line integrated system for identifying and selecting high risk shipments. The system also contains a statistical selection mechanism which is being used in an effort to ensure adequate coverage in the selection of commercial shipments for examination. An overall commercial compliance rate is still not measured. However, compliance rates for limited segments of commercial operations have been measured using means other than the CCS.

> 7.104 The Department should, as soon as practical, provide a profiling system to assist Commodity Specialists and Dominion Customs Appraisers in selecting high-risk entries for assessment.

20.58 A system has been formalized through CCS for selecting entries. This system is also equipped with a random selection feature that establishes minimal coverage of entries. However, the newly established data bank does not yet provide for the selection of all high risk entries due to the limited number of regional criteria which have been instituted to date.

20.59 Two additional recommendations in this area have not been affected by the implementation of the CCS.

> 7.93 The Department should regularly verify, for all modes of transport, compliance with the requirement to declare goods being imported.

20.60 The Department has since enhanced its methods of ensuring accurate declaration of goods by formalizing detailed reporting of carrier profiles. The data bank for the carrier profile system is in an early development stage, and completion will require continual co-operation from the regions.

> 7.96 The Department should ensure that an adequate level of audit coverage of Post-Audit Carriers is maintained.

20.61 To improve audit coverage, the Department has formalized its planning system for selecting Post-Audit Carriers and staff for the conduct of these audits. It is too early to determine whether audit cycles for individual risk categories will prove reasonable, or whether they will be respected.

Measurement of Enforcement Results in Customs Port Operations

> 7.125 The Department should ensure that it has sufficient objective and reliable information on the level of compliance in Passenger and Commercial Operations and on its success in detecting non-compliance.

20.62 In our follow-up review we found that the continuous performance information system for air passengers, which was in place and operating in 1985, had been suspended in favour of a periodic sampling measurement system. The results from this measurement system were finalized and reported in March 1988, and the Department plans to continue this type of measurement for 1988-89. As of March 1988, passenger travel and commercial operations, other than air passenger travel, had not been provided with a mechanism for detecting the overall level of compliance and the corresponding rate in detecting non-compliance. However, the Audit and Evaluation Branch has measured the compliance rates in specific commercial areas.

Conclusion

20.63 Progress has been made in addressing the majority of our recommendations, even with the significant events affecting the Department. However, since 1985 no progress has been made in the overall measurement and reporting of compliance or the rate of detecting non-compliance, except for air passengers, although some segmented compliance rates have been measured in specific areas of Commercial Operations. Since several key recommendations have been addressed recently, it is premature to report on the success of the measures implemented.

LAW REFORM COMMISSION OF CANADA - 1985, CHAPTER 10

Introduction

20.64 Our 1985 audit focussed on the implementation of the Commission's Research Program and on project management procedures. It included, as a case study, an examination of one of the Commission's major research projects, the Criminal Law Review Project, which is a joint undertaking by the Commission, the Department of Justice and the Ministry of the Solicitor General. We did not examine the quality of the research work.

Findings

20.65 **Research Program.** The Commission has revised and updated its Research Program and has recently submitted it for ministerial approval. It now provides information on the Commission's current and proposed activities. Although we recognize that legal research is a complex undertaking and that it is difficult to accurately estimate time requirements, more information is still needed. For example, we believe the document would be improved if it included more detailed information on each research project, such as the approximate start and finish dates and the estimated total cost. The only cost information now included in the document is an indication of what percentage of its annual budget over the next five years the Commission proposes to spend on each of the six research projects comprising the program. The Commission, following our review, is currently revising its Research Program to include more information on timing, cost and completion dates for the research projects.

20.66 The Commission has undertaken some preliminary work in program evaluation. But it has yet to carry out an overall effectiveness evaluation of its program. This can be done only after clearly determining how to measure the effectiveness of the program; we acknowledge that it is a difficult task. In the meantime, the Commission is using a number of indicators as partial measures of effectiveness. Some of these indicators are the number of reports submitted to Parliament, the number of its recommendations implemented by new legislation, the number of times its recommendations are cited by the judiciary, the number of draft bills introduced but not enacted and the use made of the Commission's work by faculties of law.

20.67 **Project management.** The Commission has improved its project management procedures. Work plans are now included in the contracts of project co-ordinators and of other consultants. These work plans contain adequate data for monitoring activities and related projects or sub-projects. Senior management monitors activity informally and through personal contact with the project co-ordinators and with other consultants.

20.68 The Commission has documented both its procedures for hiring consultants and its Administrative Committee's terms of reference, and also carries out appraisals of the consultants' performance.

20.69 The Commission has recently completed the first part of its review of the Criminal Law Review Project (called "the substantive aspects"). Tabling in Parliament of the related report was tentatively scheduled for May 1988. General improvements in project management practices have addressed our specific recommendations regarding this project.

Conclusion

20.70 The Commission has acted on our 1985 recommendations and, in general, has implemented reasonable measures. However, further improvement is required. The Research Program should present better information on resource needs and on time frames for completing the suggested research projects; the Commission is currently addressing this issue.

CANADIAN HUMAN RIGHTS COMMISSION - 1985, CHAPTER 11

Introduction

20.71 Our 1985 audit focussed on the Commission's major activity, managing complaints from individuals. We also examined the Commission's interpretation of its role and mandate as well as its strategic and operational planning.

Findings

20.72 **Processing and managing complaint investigations.** The Commission has made progress in identifying the nature and underlying causes of delays in investigations. It has yet to determine which of those causes it can address. Furthermore, despite improvements in processing complaints, the number of outstanding cases continues to increase. At the end of December 1987 the number was 972, an increase of approximately 43 percent over March 1985. The Commission actually closed more cases in 1986 (302 cases) and 1987 (373 cases), but the number of complaints accepted each year has increased. The Commission believes that the proportion of complaints being substantiated and channelled toward adjudication will continue to increase and that, as a result, and with the current levels of resources, the number of outstanding complaints will not be decreased in the near future.

20.73 The Commission has taken a number of steps to improve the way it processes complaints. To start with, it has issued a comprehensive operating manual which defines the roles and responsibilities of all parties involved. It also contains policies and procedures, including work tools such as forms and specimen letters to be used during complaint investigations. In addition, the Commission has developed qualitative and quantitative standards of performance and work, which are also used in resource allocation. Finally, it has developed a quality assurance program, although it is currently reviewing it to make improvements.

20.74 Notwithstanding these changes, further improvements are required in two important aspects. First, the Commission still undertakes complaint investigations on a first come-first served basis. It has indicated that future improvements in planning will permit the allocation of more resources to handling some complaints on a priority basis.

20.75 Second, the management information system is not adequate to assist managers in monitoring the progress of complaint investigations and the productivity of the investigating staff. The system produces various statistics and provides periodic status reports on each complaint investigation. However, the information is often out of date. This lack of adequate management information also contributes to the delays in investigations.

20.76 **Role, mandate and planning.** The Commission has identified ways to address its dual mandate, of enforcing compliance with the provisions of the CHRC Act and educating the public about those provisions, through its new planning process, which it implemented in 1986. It includes a strategic plan, updated annually, and annual operating plans. The strategic plan defines long-term priority objectives and strategies to achieve them. The Commission is working on further improvements to its planning process.

Conclusion

20.77 The Commission has acted positively on our 1985 recommendations and has initiated corrective action on all issues. Further improvements are under way and the Commission is looking for ways to reduce the backlog of complaint investigations.

INCOME TAX EXPENDITURES - 1986, CHAPTER 4

Introduction

20.78 In our 1986 chapter on income tax expenditures, we discussed the risks involved in using the income tax system to deliver programs; the management of tax expenditures by the Department of Finance; the tax system and Crown corporations; and the information Members of Parliament receive about income tax expenditures. We made recommendations on each of these topics.

20.79 Our follow-up review focussed on whether action had been taken by the government or by the Department of Finance in response to our recommendations. Our findings follow under appropriate headings from, and with paragraph references to, the 1986 Report chapter.

Taxpayer-induced Avoidance Mechanisms

20.80 The first recommendation (4.54) covered taxpayer-induced avoidance mechanisms.

20.81 The government has improved the timeliness with which it reacts to taxpayer-induced avoidance mechanisms. This is usually accomplished by issuing a press release from the Department of Finance as soon as the government's reaction to the mechanism has been determined. The press release may include draft legislation or an indication of what will be in the legislation, but this is not always the case. When the implementing legislation is enacted, it is effective from the date of the press release.

20.82 Dealing with taxpayer-induced avoidance mechanisms on a timely basis is a difficult task. Press releases announcing changes can be effective in stopping a revenue loss due to the identified mechanism. However, until legislation is presented to Parliament, taxpayers have a degree of uncertainty about the law. Should future press releases on avoidance mechanisms become necessary, we would encourage the Department of Finance to include draft legislation in the press release and to present the appropriate legislation to Parliament at the earliest possible moment.

Managing Tax Expenditures

20.83 Three recommendations (4.100, 4.103 and 4.105) dealt with the management of tax expenditures, concentrating on their evaluation.

20.84 One of our concerns was that, before being implemented, tax expenditures were not subjected to appropriate procedures, including an appropriate analysis. Since our chapter was written, the most significant change in the income tax area has been tax reform, which eliminated a number of tax expenditures. Department of Finance officials testified extensively at parliamentary committees on tax reform, explaining the reasons behind the government's proposals. The increased emphasis on consultation and the testimony given before parliamentary committees provide some evidence that more analysis of tax expenditures is being carried out at the pre-implementation stage.

20.85 The Department has improved its post-implementation procedures. A tax measures evaluation unit has been set up to provide evaluations independent from line management. The unit has succeeded in attracting qualified staff, is currently undertaking its first evaluations, and has plans for future evaluations. We are encouraged by these developments and will continue to monitor the Department's progress. With respect to monitoring tax expenditures, some improvement has been made for those that were recently introduced into the system or substantially altered. For example, taxpayers wishing to use the Cape Breton Investment Tax Credit must have their projects pre-certified. Also, taxpayers seeking refunds of Investment Tax Credits for scientific research must have their claims audited before payment unless they have demonstrated an acceptable track record in research and development.

The Tax System and Crown Corporations

20.86 In paragraph 4.112, we recommended that the government ensure that the confidentiality provisions of the Income Tax Act do not hamper Parliament's ability to receive all relevant information on Crown corporations.

20.87 The government has taken no action on this recommendation. The Minister of Finance has said in a letter to the Public Accounts Committee that he considers the provision of explicit information on tax expenditure use by Crown corporations to be neither necessary nor appropriate. We disagree with this position because Crown corporations that are technically defined as taxable Canadian corporations are able to bypass the normal parliamentary budgetary processes and obtain additional funds through the tax system.

Information to Parliament

20.88 Two recommendations (4.147 and 4.149) dealt with the information on tax expenditures available to Members of Parliament at the time of the regular budgetary and spending review process and when Parliament is requested to enact technical amendments to the Income Tax Act.

20.89 The government has not produced a tax expenditure account since 1985. The Minister of Finance has said that the government is committed to the regular publication of valid, useful and acceptable measures of accountability in taxation. He has directed the Department of Finance to conduct extensive consultations and discussions on the subjects of tax expenditures and accountability in taxation, with a view to determining what information would be most useful to Members of Parliament. Results of the study are not expected before the end of 1988. We welcome the government's commitment to provide valid and useful information. However, although we recognize the difficulties involved, we believe it would be better to publish some information on a regular basis, with refinements to follow, than to wait until all the kinks are ironed out.

Conclusion

20.90 The Department of Finance has addressed many of our recommendations. In our opinion, the provision of information on the use of tax expenditures by Crown corporations is the one major issue that remains outstanding. Other issues will require further monitoring to ensure that the results envisaged are in fact achieved.

MINISTRY OF THE SOLICITOR GENERAL - CORRECTIONAL SERVICE OF CANADA - 1986, CHAPTER 7

Introduction

20.91 In 1986 we examined the major activities of the Correctional Service of Canada (CSC): inmate accommodation; inmate population management, including education, training and employment of inmates; the Parole program; recruitment and training of personnel and monitoring of overtime; and support services such as the financial function, internal audit, program evaluation, materiel management and reporting to Parliament.

20.92 The most significant issues reported on in 1986 were:

- inmate accommodation;
- inmate population management; and
- management of the correctional staff.

Findings

20.93 **Inmate accommodation.** In 1986 we reported a significant imbalance between the planned capacity of institutions and forecasts of the inmate population at the medium and maximum security levels. As a result, there was going to be excess capacity in some areas and a shortage of capacity in other areas. This surplus capacity would lead to significant extra expenditure, while the shortage would result in increasing use of double bunking in some regions, with all its attendant negative effects.

20.94 There were also serious weaknesses in the accommodation planning process and in project management procedures, which led to costly changes in plans and design after construction projects had begun.

20.95 **Policy, planning process and plans.** CSC has reviewed its accommodation policy and has made some revisions, which are reflected in the 1987 update of its Long Range Accommodation Plan (LRAP). In April 1988, Treasury Board approved the LRAP and approved in principle the proposed capital construction projects, with some exceptions. However, CSC has not yet carried out a cost-effectiveness analysis of its accommodation policy, particularly with respect to the part relating to the special categories of inmate population. These categories represent about nine percent of the total inmate population. CSC plans to carry out the required analyses before finalizing, documenting and communicating its accommodation policy to all the parties concerned.

20.96 CSC has also improved its accommodation planning process. The revised process calls for the monitoring and co-ordination of regional accommodation plans, which should be supported by adequate cost-benefit analyses, and for an annual updating of the Long Range Accommodation Plan. For the most part, CSC followed its revised process in 1987. However, closer adherence to the process is required; we noted significant revisions to proposed accommodation plans without adequate cost-benefit analyses. CSC has updated its LRAP and has indicated that it will continue to review it annually to make adjustments for significant unforeseen developments.

20.97 CSC has revised its accommodation plans to ensure closer matching of planned capacity with forecasts of the inmate population by security level and region. To achieve this, CSC plans to phase out capacity in part or in total at some existing institutions, to use surplus capacity at maximum security institutions to meet shortages at other security levels, to build new capacity at the medium security level and to increase the use of exchanges with provinces. As a result, the overall planned capacity outlined in the 1987 LRAP generally matches the forecast of the inmate population, over the planning horizon. This match takes into account the acceptance of temporary double bunking to a maximum of 10 percent of the inmates by region, as proposed in the accommodation policy.

20.98 Since our 1986 audit, CSC has almost completed the construction of a penitentiary in Port Cartier. As a result, CSC will face extra operational costs of about $30 million over the life cycle of this institution, as noted in our 1986 Report. CSC has taken into account the planned capacity of this institution in revising its accommodation plans.

20.99 **Project management.** CSC has revised its project management process by developing and issuing improved planning and construction procedures and by implementing control measures. These steps require the identification of standards and requirements for new accommodation before its design is undertaken and should minimize changes during construction.

20.100 **Inmate population management.** In 1986 we reported that CSC had no documentation systematically aggregating inmates' needs and, as a result, was unable to develop an overall picture of the extent to which those needs were being met. Furthermore, improvements in efficiency and effectiveness measures of inmate education, training and employment programs were also required.

20.101 The Parole program had no explicit criteria for making decisions on granting parole and no evaluation of the program had yet been carried out.

20.102 **Case management.** Work is ongoing to identify the inmates' needs and to measure the extent to which they are met. In 1987, CSC started to implement its "Case Management Strategy", an improved and more focussed case management method aimed at identifying the root causes or factors that led to an offender's criminal behaviour. Once these have been determined, the inmate's most important needs can then be specified. These are still recorded by hand in the inmate file but CSC anticipates that its new Offender Management System, currently under development, will permit the systematic aggregation of inmates' needs. This should provide a basis to measure the extent to which needs are being met.

20.103 **Industries Program.** CSC has reviewed and redefined the objectives of the former Industries Program (now part of the Occupational Development Program); nevertheless, additional effort is required for clearly defining some key terms used in the wording of the objectives with a view to operationalizing them. For example, CSC has yet to clearly define key targets for good work habits and transferable skills, although it has taken some initial steps. In addition, measures to assess the effectiveness of this program still need to be developed.

20.104 CSC is continuing to address the constraints facing the Industries Program; for example, by experimenting with monetary incentives for inmates to enhance productivity. It has also implemented better management controls over the inventory of finished goods and is looking for ways to improve marketing of them.

20.105 **Education and training program.** CSC has taken initial steps to identify key indicators of program efficiency and effectiveness. It has also issued national guidelines for the quarterly collection of program effectiveness information from all institutions. However, it has yet to develop formal systems and procedures to ensure that information about individual inmates is automatically transferred to the Case Management group. CSC plans to address this issue with the development of its Offender Management System.

20.106 **Parole program.** CSC and the National Parole Board (NPB) have worked together on a number of evaluation projects relating to Bill C-67, now part of the Parole Act. This Bill broadened the discretionary powers of the NPB by enabling it to continue the confinement of certain inmates past their normal automatic release at the mandatory supervision date. Other inmates may benefit by obtaining an earlier release, because the Bill provides for automatic review after one-sixth of a sentence has been served.

20.107 The Bill has had a profound impact on the operations of the NPB and CSC. Full evaluations of the "detention" and "early release" provisions of the Bill are either under way or will be started in the near future, and will be considered a partial evaluation of the Parole program.

20.108 At the beginning of 1988, the NPB issued its "Pre-Release Decision Policies", designed to make explicit to all interested parties the criteria used and the process followed in making Board decisions. NPB plans to monitor the policies closely during the first year of their application with a view to eventually evaluating them.

20.109 **Management of correctional staff.** In 1986 we reported that the overall program of recruitment, training and development of correctional officers needed further review, due to operational changes aimed at cost reduction and decentralization. Furthermore, the monitoring of overtime expenditures for the correctional officer group needed improvements.

20.110 **Recruitment, training and development of CX Officers.** CSC has adopted a set of principles providing for continuous and meaningful interaction between staff and inmates, integration of the custodial and inmate management functions, staff participation in the decision-making process and delegation of authority to the lowest level possible, including increased responsibility for decisions and actions. These principles are directly linked to the CSC Mission Statement.

20.111 Based on these principles, CSC developed its recruitment program and staffing tools designed to standardize recruiting across all regions. CSC is currently developing an automated tracking system to monitor the performance of new recruits during their first two years. It has also undertaken a comprehensive review of its training activities, with a view to developing training programs to meet the needs of Correctional Officers at all levels.

20.112 **Overtime control.** Overtime budgets are still based largely on historical patterns of overtime usage adjusted to reflect the objective of reducing overtime expenses. CSC has strengthened its procedures for monitoring overtime and has hired some part-time Correctional Officers. However, CSC has yet to determine the optimum level of overtime necessary to operate economically and efficiently. Thus, it does not know what would constitute a realistic goal in its efforts to reduce overtime expenses.

20.113 **Financial function.** In accordance with the views of the Department's senior management, the Finance Branch is playing an increasing role in the decision-making process. Usually, the Finance Branch is asked to provide advice and to review and/or carry out financial analyses of major initiatives.

20.114 **Materiel management.** CSC has begun to develop an automated corporate asset management system to control materiel. Until the system is implemented in 1990, most of the deficiencies identified in our 1986 audit will continue to exist.

20.115 **Internal audit.** CSC has clarified the role and mandate of the Inspector General's Branch and has set policy to ensure the independence and objectivity of the internal audit function. The Branch has taken action to strengthen its expertise in value-for-money auditing and in computer auditing. However, further improvements are required in planning, controlling and documenting management reviews, although we noted some improvement since 1986. The Branch has indicated that it will continue to address these issues.

20.116 **Program evaluation.** The program evaluation function is now fully operational and is an integral part of the management process. Although at the time of our follow-up CSC had yet to complete an evaluation of any major part of its operations, it had completed some evaluation projects. Current departmental policy on program evaluation, issued in January 1987, calls for a review of each program at least once every five years. The five-year evaluation plan submitted by the Program Evaluation Unit is adjusted annually, in accordance with senior management's priorities.

20.117 **Reporting to Parliament.** CSC has assigned to one group the responsibility for co-ordinating and preparing reports to Parliament. This approach should improve the presentation of information in its Part III Estimates and in its annual report (included in that of the Solicitor General).

Conclusion

20.118 CSC has taken or is taking corrective action on all issues raised in our 1986 Report. However, although corrective action is generally proceeding, there are a number of significant issues that have not yet been fully resolved. For example, CSC still requires:

- cost-effectiveness analysis to support CSC's accommodation policy;
- better definition of some key terms used in the wording of the objectives of the Industries Program;

- systems and procedures for the automatic transmittal to the Case Management group of information on the performance of inmates participating in the Industries and Education and Training programs; and
- determination of the optimum level of overtime to be incurred by its CX group.

DEPARTMENT OF AGRICULTURE - 1986, CHAPTER 8

20.119 Our 1986 audit addressed the Department of Agriculture's delivery of farm income services; its management of the research branch; efforts to improve domestic and international markets for Canadian products; the services and programs offered by the Prairie Farm Rehabilitation Administration; and the controls surrounding toxic waste and hazardous materials. Our report included several recommendations in these areas.

20.120 The 1986 Report chapter was considered at two sessions of the Public Accounts Committee, on 28 and 30 April 1987. The Committee was concerned with the Department's slow progress in implementing recommendations from earlier audits. It asked the Department for a report in writing, by 29 January 1988, on progress as of 31 December 1987 in implementing our recommendations.

20.121 The Committee also asked the Department to provide us with a copy of the response so that we could follow up on it, on behalf of the Committee, and report the results within a reasonable period.

20.122 We have received the Department's original response. Our preliminary assessment earlier this year was that the Department had made progress, through 31 December 1987, in implementing our 1986 recommendations. However, some work remains to be done. The Department's target date for completing a large number of the planned corrective measures was 31 March 1988, with the final target completion date set for 31 October 1988.

20.123 In the circumstances, we decided to defer our full follow-up and related report to next year. This would permit us to examine the implementation of all the planned corrective measures and to provide the Committee with an overall assessment of their appropriateness.

DEPARTMENT OF EXTERNAL AFFAIRS - TRADE FUNCTION - 1986, CHAPTER 9

Introduction

20.124 The 1986 value-for-money audit of the Department of External Affairs Trade function focussed on trade development and related program administration. The recommendations of the 1986 Report chapter dealt with levels of service, cost recovery, trade and market information, post planning and monitoring, interdepartmental operating relationships and human resource management. In addition to explicit recommendations in these areas, the 1986 Report also contained observations on the Program for Export Market Development

(PEMD) and the Department's procedures for measuring and reporting on the effectiveness of the Trade function.

20.125 The Public Accounts Committee (PAC) made recommendations and observations in its Sixth Report, dated 20 May 1987, that reiterated many of ours. The Committee reserved comment on PEMD pending the results of our follow-up in this area.

Scope and Methodology

20.126 In our follow-up of the 1986 Report, we reviewed the actions taken by the Department of External Affairs to address our recommendations and our observations in the areas of PEMD and effectiveness measurement.

20.127 We discussed with management in Ottawa the implementation of the recommendations and reviewed documentation provided to us. We also conducted follow-up visits at two posts in the United States to obtain the views of personnel on site.

Overall Conclusion

20.128 The Department has dealt with most of our 1986 recommendations. However, after further study in the areas of levels of service, cost recovery, and post planning and monitoring, it has decided not to implement our recommendations fully at this time. The Department's position and our own views on all the issues are set out in the paragraphs that follow.

Levels of Service

20.129 Our 1986 Report stressed the need to establish and agree on the levels of service to be provided by the posts. (Level of service refers to both the type and amount, or extent, of service to be provided.) Appropriate levels of service would be tailored to meet local conditions and would respond to requests for assistance received from the business community. We noted that the Department had no documented standards against which to measure its Trade officers' activities in meeting these demands for service. Individual Trade officers made daily decisions based on their own judgment or interpretation of the desirable level of service. This had led to wide variations in the emphasis given to particular kinds of work performed in support of the Trade function. Our principal concern was the need to establish an appropriate basis for allocating staff and controlling costs.

20.130 The Department has taken steps to establish a standardized list of the types of services provided at posts abroad and to communicate it to the business communities. However, this is a general list and it does not capture variations in the types of service that are provided at different posts. The Department has decided not to further define the levels of services offered. It has come to the conclusion, after consultations with officials and business people, that the extent to which specific services are offered and the manner in which they are provided are satisfactory.

20.131 The levels of service provided are decided at posts on a case-by-case basis, by Trade officers who are expected to use their own judgment and, more generally, by Headquarters staff who determine resource levels based on a variety of factors, particulary the potential for export success. Levels of service are also influenced by overall resource constraints resulting from the priority being given by the government to deficit reduction. The Department does not consider it appropriate to specify either the type or amount of service on an aggregated or a post-by-post basis. Maintaining program flexibility by allowing for the exercise of judgment is considered of vital importance to the Department. It believes the government's trade promotion effort would not noticeably benefit from taking the "defined levels of service" idea further, as recommended by this Office and by the Public Accounts Committee.

20.132 The Department's views on levels of service have been noted. We believe that our recommendation can be pursued in the context of cost recovery.

Cost Recovery

20.133 In 1986 we recommended that the Department further examine cost recovery possibilities for the Trade function and make appropriate recommendations to the government. We observed that, since many of the services offered were being rendered at the request of identifiable groups or individuals, consideration should be given, as provided for in the Treasury Board's Guide on Financial Administration, to whether the cost of these services should be borne by them. We also observed that partial cost recovery is a potential means of imposing additional rigour on individuals or organizations requesting the service, which could lead to greater efficiency, economy and effectiveness in the Trade function.

20.134 The Department has conducted a limited review and held discussions on the feasibility of introducing further cost recovery measures. However, it has not undertaken a comprehensive examination of the impact on economy and efficiency that introducing cost recovery for services at posts abroad would have. Also, it has not pursued our suggestion that an explicit recommendation be made to the government.

20.135 Such a comprehensive examination would require studies of all Trade function costs. It would also include cost-benefit analysis to determine which costs should be absorbed by the government; allocation of costs among services and user groups; assessment of the price responsiveness of different user groups to varying levels of services; and consideration of alternative cost recovery targets and charging mechanisms for Trade officers' time and for other services provided to business.

20.136 The Department informed us that it has introduced enhanced cost recovery in the trade fair and missions area and charged a registration fee for companies seeking interviews with the trade commissioners brought back to Canada for "Marketplace '87". It has also issued instructions to officials to be vigilant regarding any additional potential for cost recovery. It does not believe much more can be done without reducing the cost effectiveness of the Trade function.

20.137 We believe that a more comprehensive examination is needed to determine whether extending cost recovery for at least some of the services provided at posts would be desirable and to support an appropriate recommendation to the government.

Interdepartmental Operating Relationships

20.138 We were concerned in 1986 that the Department had not reached a consensus, at the operating level, with other government departments on the best method of working together in pursuit of trade objectives. This concern led to a recommendation that External Affairs establish guidelines on operational relationships with other government departments that have an ongoing involvement in developing and implementing Trade policy.

20.139 The Department has made progress in this area, improving communication with other departments through increased emphasis on consultation and co-ordination, new memoranda of understanding and more active interdepartmental committees. Improved planning processes provide a forum for the continuing development of operational relationships and for resolution of interdepartmental issues.

Post Planning and Monitoring

20.140 We found in 1986 that instructions and controls in the post planning system did not sufficiently address attributes of good planning information, such as completeness, quality and validity at all operational levels. Also, the planning process did not formally consider alternative delivery options in allocating funds; and there was no monitoring system to ensure adherence to plans or to collect data on the results of various activities.

20.141 We recommended that the Department ensure that the planning system contain accurate information on all post activities, so that Trade officers' time could be allocated with the most effective mix of responsive activities and new initiatives.

20.142 The Post Planning and Tracking System, introduced since our 1986 audit, constitutes an important step in the development of planning mechanisms in the Department. Information on the allocation of total available time by each Trade officer at each post is projected, and its distribution by economic sector in export promotion is established during the planning stage. However, the plan does not contain information on how each Trade officer's time is to be divided between responsive activities and new initiatives. The Department maintains that it is difficult to distinguish between the two.

20.143 We also recommended that the Department of External Affairs monitor Trade officers' activities and compare the results of these activities against post plans and objectives as a basis for assessing alternative delivery options.

20.144 The Department now does this to the extent that, for key activities, it keeps track of actual results against anticipated results. This is a significant improvement since our 1986 audit.

20.145 The Department has no provision in its planning system for specific allocation of Trade officers' time, between what it defines as "key" activities and other activities. It is therefore not able to formally monitor the extent to which Trade officers are allocating sufficient time to activities that Headquarters has agreed are the key activities for the post. Furthermore, without specific information on the planned and actual time spent on these key activities, it is difficult to assess their cost effectiveness. As a result, the Department's ability to evaluate the costs and benefits of alternative delivery options remains limited.

Program for Export Market Development (PEMD)

20.146 We reported several concerns about PEMD in 1986. The eligibility criteria for receiving funds under the program had not been met in some cases; monitoring of larger projects was inadequate; adequate qualitative information on program results had not been collected; and procedures to identify and collect receivables did not ensure maximum recoveries.

20.147 Eligibility criteria for receiving funds are now being applied. Companies that have been unsuccessful, that have not submitted required Business Development Reports or that have unrealistic marketing plans are not eligible for PEMD contributions. Proposals that are not viewed as being incremental will also be rejected.

20.148 Procedures for identifying and collecting accounts receivable have been improved. Auditing of contributions for potential repayment has been significantly increased. We were informed that the number of repayments subject to audit has increased substantially. Monitoring of the export performance of companies also has been improved. Procedures are being instituted to regularly monitor larger projects.

20.149 Procedures for measuring program effectiveness have been strengthened, in that there is now a plan for collecting data for future evaluation of the program. However, discussions on the assignment of specific responsibilities for data collection are still in progress. Assigning such responsibilities will increase the likelihood that the specified data will be gathered in a timely and economic manner. Some of these data may have to be collected by other government departments. In addition, operational targets for the program, such as improving the level of business activity, expanding the number of business contacts and identifying suitable local representation, have yet to be established.

Market Information

20.150 In 1986 we reported a need to develop and implement a management framework to ensure that important export sectors are supported by market intelligence, co-ordination with other government departments and dissemination of market strategies to industry.

20.151 The Department has made serious efforts to address this need through its Post Planning and Tracking System, now operating in conjunction with its resource management annual cycle as part of the Department's overall planning process.

20.152 The system provides a sound framework for disseminating and co-ordinating market strategies and intelligence among government departments, the provinces and industry.

Trade Information

20.153 We noted in 1986 that there was little uniformity or consistency of analysis in the use of trade statistics in the Department. We recommended that the Department assign responsibility to a specific responsibility centre, to establish and implement policies on collecting, analyzing and disseminating trade information.

20.154 The Department has given the Economic and Trade Analysis Directorate responsibility for collecting, reconciling, interpreting and presenting internally consistent trade and economic data in support of priority departmental programs, and for providing guidance to other bureaus on the use and limitations of statistical information.

Human Resource Management Policies

20.155 The 1986 Report recommended establishing clear guidelines for the management of human resources. We considered such guidelines to be important tools for post managers in reaching decisions on whether to staff positions with Canada-based or locally-engaged employees and whether to staff with specialists seconded from other organizations. Clear guidelines would also help decide on appropriate training for staff and on the duration of postings.

20.156 Since 1986, the Department has converted a number of positions from Canada-based to locally-engaged status and has revised the policy guidelines on postings to encourage longer assignments, particularly in relation to level III hardship posts, where the standard two-year posting has been extended to three years. In addition, it has developed a policy and specified the factors to be used in deciding whether to staff with Canada-based or locally-engaged staff. However, this policy had not been formally disseminated to posts abroad as of 31 March 1988.

20.157 A personnel policy dealing with the training of staff has been promulgated.

20.158 With regard to the use of specialists, the Department informed us that it is considering a "cadre concept", envisaging the establishment of talent pools of specialized expertise to ensure that people with the necessary talents are identified and available for placement at posts abroad.

Human Resource Management Information Systems

20.159 Our recommendation on human resource management information systems resulted from a concern that the Department's information systems did not allow for the comprehensive matching of personnel skills with job requirements. This recommendation had not been fully addressed as of 31 March 1988. We were informed that implementation of a comprehensive system (PERNET) has been deferred, due to the higher priority of the World Information Network (WIN) and the Canadian On-line Secure Information and Communications System (COSICS). The Department told us that PERNET will be further considered when COSICS computer equipment has been selected and is operational.

20.160 The Department has established, as an interim measure, a stand-alone microcomputer system to carry out the matching of skills to job requirements. However, not all the required data on skills and job information have been entered. We were informed that data entry would be completed and the improved system would be fully operational by 31 August 1988.

Effectiveness Measurement and Reporting

20.161 We observed in 1986 that the Department's measurement and reporting of Trade function effectiveness were not adequate. Its evaluation plan called for only a limited amount of such information. We also observed that there were no agreements or understandings on how trade activities were to be evaluated where they were shared with other government departments.

20.162 The Department has now completed a substantial amount of work on measurement. In particular, the evaluations and resource reviews conducted, and the implementation of the Planning and Tracking System, begin to address the need for information on effectiveness. Additional work remains to be done in such areas as specifying the precise measures of results of the Trade function, and in assessing the feasibility of attributing changes in these results to specific initiatives of the government departments involved.

20.163 Explicit specification of user needs and of related levels of satisfaction as an effectiveness measure are also needed. Finally, the Department should continue to develop indicators of performance. This would further assist the measurement and reporting of how well Trade officers are contributing to the Trade effort.

DEPARTMENT OF INSURANCE - 1986, CHAPTER 12

20.164 This follow-up covers all the major observations and recommendations we made in 1986 as well as the progress of the initiatives that were under way at the time of our audit.

20.165 In July 1987 the operations of the Department of Insurance and the Inspector General of Banks were merged into the newly created Office of the Superintendent of Financial Institutions (OSFI). The legislation establishing the new Office also gave the federal government stronger regulatory powers over the institutions.

20.166 At the time of our follow-up in May and June 1988, the Office was in the process of formulating strategic and operational plans, advising on the development of new legislation for financial institutions, reviewing its current methods for assessing financial solvency of these institutions, and implementing new operating systems and procedures.

Supervision of Financial Institutions

20.167 The former Department of Insurance was responsible for supervising the activities of the trust and loan and insurance companies.

20.168 In 1986 we recommended that the Department improve its process for monitoring and assessing the financial solvency of the companies it regulated, and increase the efficiency of its regulatory process. We also noted that standards and procedures for carrying out supervisory activities were informal in many areas, and work tools were outdated and inefficient, but that there were efforts under way in the Department to address these matters.

20.169 **Trust and loan companies.** At the time of our review, the supervisory activities for the trust and loan companies had recently been amalgamated with the banking activities in the Deposit Taking Institutions Sector of OSFI. The Office was also in the process of examining its current approach to assessing financial solvency of these organizations. In addition, a major reorganization was under way, including recruitment efforts to staff recently created senior management positions, and most of the operations were being transferred to Toronto.

20.170 All these efforts are indicative of a desire to strengthen the supervisory practices. But, until operating systems and procedures are more firmly established within the Sector, we are unable to assess the full extent of the progress made to address our recommendations.

20.171 We did note, however, a significant improvement in the field examination process for trust and loan companies. There is better documentation of risks considered and evaluated during the examination, improved co-ordination with the external auditors and evidence of proper review and supervision.

20.172 **Insurance companies.** Important progress has been made in addressing many of our observations about the supervision of insurance companies. For instance, risk assessment procedures have been better defined, the number of specialist positions have been increased and other positions have been upgraded. Systems and procedures in all areas of the insurance operations are better documented. As with the trust and loan companies, field examination procedures have been significantly improved and streamlined.

20.173 There are a number of areas affecting both trust and loan and insurance companies where progress has been slow because the issues are being addressed from an Office-wide perspective. For instance, we recommended that more time be devoted to reviewing and assessing future industry trends. Responsibility for this activity has been centralized, but it is not expected that the function will be operational before March 1989. In another area, the introduction of computer technology has been slow. Currently, the Office is in the process of developing a computerized institutional information system which is expected to be fully implemented by early 1989.

Supervision of Pension Plans

20.174 **Pension reform.** Amendments to the Pension Benefits Standards Act came into effect 1 January 1987, bringing with it an increased workload for the Pension Benefits Division. We recommended that work plans be developed to deal with the changes in legislation, so the Division could cope with the increased workload in an efficient and effective way. Plans were developed, but the amount of work involved in dealing with the new legislation was underestimated, and a backlog resulted.

20.175 At the time of our review in June 1988, the Division was behind in completing detailed reviews of annual information returns. This was due in part to the increased workload under the new legislation. For instance, one of the new legislative requirements is the submission of amended plan texts, all of which are due by 31 December 1988. As of early June 1988, of some 900 plans regulated by the Pension Benefits Standards Act, 259 had been received, 125 had been reviewed, 4 were registered and 2 were ready for registration. The Office was aware of the situation and was in the process of recruiting additional resources.

20.176 **Assessing financial solvency.** In 1986 we recommended that the supervisory practices for pension plans be thoroughly reviewed. We were particularly concerned that there was no formal process for assessing risk, few field examinations were being carried out and procedures for monitoring pension plan assets were inadequate. We also recommended that there should be procedures in place to ensure adequate supervision of the pension plans that are monitored by provincial authorities under reciprocal arrangements.

20.177 In response to our recommendation, an extensive evaluation of the supervisory process was carried out. This was completed in July 1987. An action plan to address the study's recommendations has been drafted, and steps are now under way in a number of areas to improve systems and procedures. The draft plan calls for full implementation of the recommendations by 31 March 1989.

20.178 It is too early for us to assess the full extent of the improvements. However, the new legislative change, which calls for annual audited financial statements rather than the previously required triennial information, together with the implementation of the study's recommendations, should considerably improve procedures for monitoring pension plan assets. Reciprocal agreements with provinces are being rewritten. The planned field examination of some 40 plans each year, beginning in 1988-89 (up from the previous two or three a year), together with the development of examination standards and guidelines of the same calibre as those for financial institutions, should significantly strengthen the supervisory process. However, given that there are some 900 plans, the Office should monitor this process closely to ensure that the scope and frequency of the examinations are sufficient.

20.179 There is still one important area that concerns us: this is the need to strengthen the risk assessment process. Although some work has been done in this area, the factors the Office takes into account in evaluating risky situations have not yet been fully defined and formally communicated to all staff involved in the supervision process. Without a clearly defined and documented process for reviewing and assessing risk, the Office may not be able to detect financial problems early enough to take appropriate corrective action.

20.180 We will continue to monitor this situation closely.

Actuarial Services

20.181 In 1986 we pointed out that there was a problem with providing actuarial reports on employee pension plans on time. There is still a problem, but the situation is improving. The average time for completing the reports has been reduced from four years to three. The actuarial staff is currently working toward meeting the recently introduced 18-month statutory requirement for tabling actuarial reports on pension plans; two of the last four major reports were completed in less than 20 months.

20.182 There is better communication with the departments responsible for providing the employee data, and the lessening of requests for special work has enabled the actuarial staff to devote more time to this area.

Reporting to Parliament

20.183 In 1986, we made recommendations to improve the annual reports and the actuarial reports that are tabled in Parliament. The quality of the annual Report on the Pension Benefits Standards Act was improved, the tabling of certain other annual Reports is no longer required and our recommendations concerning actuarial reports are currently under review.

Planning and Evaluation

20.184 In 1986, we commented on the need to improve planning and evaluation. OSFI is in the process of developing strategic and operational plans. It plans to establish an evaluation function in two years.

Cost Recovery

20.185 In 1986, we observed that billing financial institutions for recoverable costs as they were incurred, rather than annually, would result in significant savings to the government. For 1987-88, OSFI commenced a system of interim and final billings. The first interim billing was sent out in April 1988. This resulted in savings of $600,000 (this is based on billings to banks, as well as trust and loan and insurance companies). Billing on a more frequent basis would result in additional savings. We estimate that billing on a quarterly basis during the same period would have produced additional savings of $900,000.

THE VETERANS AFFAIRS PORTFOLIO - 1986, CHAPTER 13

20.186 Our 1986 audit covered Veterans' Trust Accounts, the three major expenditure areas - the War Veterans Allowance program, the Disability Pension program and the Health Services program - and extended to a number of corporate functions. We made several recommendations on the major programs and commented on the extent and quality of the procedures and practices for Veterans' Trust Accounts.

20.187 This year we followed up on all the major observations and recommendations we made in 1986. Because many of the initiatives have target completion dates after 31 March 1988, we are providing a preliminary assessment of progress.

20.188 Since the audit in 1986, the Department has instituted several reviews of its programs, administration and operations and approved an independent study of the War Veterans Allowance program and a study of the procedures and practices for Veterans' Trust Accounts. It has implemented procedures to minimize incorrect War Veterans Allowance payments and reconciled its War Veterans Allowance and Disability Pension expenditures to the government reporting system.

20.189 All these initiatives address the intent of the observations and recommendations we made in 1986. The Department has moved aggressively after deciding the most appropriate course of action for each issue.

20.190 We will perform further follow-up in 1990 when the initiatives have been completed and their operational effects are known. This will enable us to provide an overall assessment of the Department's actions.

SPECIAL AUDITS - 1986, CHAPTER 14

Free Publications

20.191 Our 1986 special audit addressed the policies and procedures regulating government publications that are made available to the public without charge. We also looked at the publishing operations of four departments.

20.192 We found a lack of due regard for economy and efficiency in expenditures on free publications.

20.193 Our 1986 recommendations therefore addressed two matters: the policies of the central agencies, such as the Treasury Board and the Department of Supply and Services' Publishing Centre, and departmental procedures. We recommended that policy and procedures be established to ensure control over the production, issue, and disposal of free publications.

Findings

20.194 The Treasury Board Secretariat believes publishing, and our concerns about free publications, are an integral part of communications activities and cannot be considered in isolation.

20.195 The Secretariat is reviewing all its communications policies as part of a communications management review being undertaken at present by the Privy Council Office (PCO). The PCO expects a policy framework for communications to be approved by late 1988.

20.196 Also as part of its internal review process, the Secretariat is seeking to ensure that communications policies are consistent with the move toward increased ministerial authority and accountability and the cost recovery/user pay policy of the Treasury Board.

20.197 Guidelines and criteria for free publications were issued in July 1988 by the Treasury Board as part of the overall policy framework for communications.

20.198 The Canadian Government Publishing Centre is emphasizing the gathering of cost data for priced publications. The Centre expects that this costing system will improve financial discipline for priced publications and will also have an effect on free publications. The Centre is responsible for carrying out reviews of departmental publishing plans.

20.199 Our review of specific departments found that they are addressing the recommendations we made as part of the process of developing new communications policies. Most of this work is at the draft stage. One department is implementing its draft policies.

Conclusion

20.200 With the exception of one department, we did not find substantial progress toward controlling departmental expenditures on free publications as recommended. Most of the progress was reflected in draft departmental communications policies.

20.201 The effect that the communications review, and the administrative procedures developed by the Treasury Board Secretariat, will have in ensuring the development of control mechanisms for free publications will have to be assessed in the future.

Department of Energy, Mines and Resources
Management of the Public Communications Function

Introduction

20.202 Our 1986 audit focussed on the management of the Communications function in the Department of Energy, Mines and Resources (EMR), and on its communication with the general public.

20.203 We found a need to improve management practices and controls.

20.204 Based on our findings we recommended that EMR clarify the responsibility and authority for managing and co-ordinating communication with the general public; that files and plans contain adequate information (including actual costs where possible) on all aspects of product planning; and that EMR examine the effectiveness of its Communications function in fulfilling program objectives, including contact with the public.

Findings

20.205 The EMR Communications Branch is beginning to address most of our recommendations.

20.206 A publishing policy has been approved for the Department. It includes definitions for scientific and general publications; the role of senior officials with respect to publishing; and guidelines and procedures for information product planning, production, distribution, disposal, control and assessment.

20.207 The EMR Communications Branch and the Mineral Policy Sector have developed procedures for preparing information product plans which will cover their objectives, costs and benefits, target audience, and distribution and storage. Other sectors of the Department are expected to follow suit.

20.208 In response to our recommendations on the need for evaluation, EMR carried out a number of evaluations in 1987 on information products and the effectiveness of the different media used. The Evaluation Officer position, established in 1986, has now been eliminated due to downsizing, and the Communications Branch plans to contract out the work. At the same time, activity in this area is expected to be scaled down due to budget restraints.

Conclusion

20.209 Some progress has been made in the improvement of management controls and practices in the Communications function.

20.210 The new publishing policy and new planning procedures are steps in the right direction. The full impact of these changes will be assessed on implementation.

Department of Energy, Mines and Resources
Canada Oil and Gas Lands Administration

20.211 Our 1986 audit of the Canada Oil and Gas Lands Administration (COGLA) recommended that outstanding transaction fees be collected and that a program evaluation study be done. We have now completed a follow-up of the two recommendations. We examined the new systems and procedures implemented by COGLA, designed to collect transaction fees. We also discussed the issue of a program evaluation study with COGLA management, officials from the evaluation branches of the Department of Energy, Mines and Resources and the Department of Indian and Northern Affairs, and the Office of the Comptroller General.

20.212 Our first recommendation concerned the lack of a system and of associated procedures for collecting revenue due the government from the granting of exploration agreements to firms exploring on Canada Lands. COGLA has since developed and implemented an accounts receivable system to handle the recording, monitoring and collection of these receivables. (Licensing has replaced exploration agreements under the Canada Petroleum Resources Act of 1986.)

20.213 Transaction fees in excess of $1 million, noted as uncollected in our 1986 Report, have been collected, with only $1,287 still outstanding.

20.214 The second recommendation was that a program evaluation study of COGLA's program activities should be completed in accordance with a timetable agreed to by the program evaluation branches of the Departments of Energy, Mines and Resources and Indian Affairs and Northern Development.

20.215 The two departments completed a joint evaluation assessment study in 1987. The study recommended a comprehensive evaluation of COGLA, covering some 17 evaluation issues, including the achievement of COGLA's objectives, the effectiveness of the Agency and the possibility of duplication and overlap with other federal agencies, which we had outlined in our 1986 Report.

20.216 However, senior officials from the two departments then met and decided not to proceed with the proposed evaluation. To support the decision, several factors were cited, the principal one being that work on key issues to be addressed in the evaluation had already been done in a number of internal and external studies. Examples of these studies include the report of the Senate Committee on Energy, which reviewed the methods for transportation of Beaufort Sea oil; a study on the Assessment of the Impact of Regulatory Regimes on Oil and Gas Exploration on Lands North of 60; and the Task Force responding to the Ocean Ranger tragedy.

20.217 Although these studies addressed some of our concerns, many important issues raised in the evaluation assessment study and in our 1986 Report have yet to be satisfactorily examined. These include the overall performance of COGLA in achieving its objective of vigorous and responsible development, and the issue of co-ordination with other departments.

20.218 Both EMR and DIAND have now included an evaluation of COGLA in their long-term evaluation schedules, although there is no apparent consensus as to the timing of the evaluation. We encourage officials in the two departments to resolve the issue of timing and to undertake an evaluation of COGLA as soon as possible.

Social Sciences and Humanities Research Council

Introduction

20.219 The Social Sciences and Humanities Research Council (SSHRC) is a departmental corporation under Schedule B of the Financial Administration Act, reporting to Parliament through the Secretary of State. SSHRC's mandate is to promote and assist research and scholarship in the social sciences and humanities and to encourage excellence therein.

20.220 Our 1986 audit of SSHRC focussed on the management process, including management roles and responsibilities, general planning and human resource management, operational control, research communication and program evaluation. We identified problems in most of these areas and made seven recommendations.

Developments Since 1986

20.221 SSHRC has undergone significant changes in its staff since the time of our report. For example, it has been without a full-time President and Chief Executive Officer since December 1987. The duties of this position are being discharged in the interim by a member of the Council. In the fall of 1987 both the Director General of Programs and the Secretary of the Council left; we have been informed that the Secretary position will remain vacant until a new President is appointed. The Director, Policy and Planning, the Director of Research Communication and International Relations, the Director of Information, the Chief of Personnel and the Co-ordinator of Program Evaluation also left in 1987.

20.222 It is understandable that these changes have had a direct impact on the nature and timeliness of actions taken by SSHRC in response to our 1986 recommendations.

Scope of Follow-up

20.223 Our follow-up of the 1986 audit consisted primarily of a series of interviews with members of senior management and other officials of SSHRC. We reviewed documents such as committee minutes, including those of Council, procedure manuals, and management and independent consultant reports. Our examination also included, on a test basis, a review of the monitoring activity over completed grant research projects.

Overall Conclusion

20.224 As of April 1988, none of our recommendations had been fully implemented. However, bearing in mind SSHRC's significant personnel changes, its efforts to address our recommendations have been tangible. Because most initiatives have been taken recently and action is still under way, these issues will be further examined during a subsequent audit.

Summary of Observations

20.225 Our 1986 audit report contained a number of recommendations aimed at achieving the following improvements:

- clarifying the managerial problem-solving process;
- reducing delays in solving problems referred to Council;
- developing and implementing operational and human resource plans;
- establishing a follow-up and review system for completed research projects; and
- systematically reporting the results of subsidized research projects.

Managerial Problem-solving Process

20.226 In 1986, we reported that SSHRC's day-to-day operations were frequently dealt with at all levels of management and there were notable delays in solving problems that were referred to Council. This increased the likelihood of inefficiency and jeopardized the best use of resources. We recommended that Council clarify the roles of different management levels and give appropriate consideration to problems brought to its attention. Neither of these recommendations have yet been implemented.

20.227 Although a draft document defining the roles and responsibilities of Council, the Executive Committee and the President is nearly complete, we have been informed that Council is awaiting the appointment of its new President as well as a revision of its by-laws before finalizing this document. Full implementation is expected in late 1988.

20.228 Our review of how Council has dealt with the delays in solving problems was limited to a follow-up of the examples illustrated in our 1986 report. Although SSHRC has taken the initiatives mentioned in this report, these problems have not been completely corrected.

General Planning and Human Resource Management

20.229 We recommended that SSHRC's senior management develop an overall annual plan defining its operational objectives and priorities and that it adopt a planned approach to managing human resources. Although neither recommendation has been implemented, SSHRC has made some attempts to address these weaknesses.

20.230 Council initially considered these observations in December 1986. Before developing the recommended plans, Council decided it needed a clearer sense of program priorities for the next few years. A task force made up of Council members was struck to define these priorities, and a second was formed in the fall of 1987 to continue the work. Among other things, this group was to design and propose new strategic programs. An interim report was tabled at the January 1988 Council meeting, at which time the idea of preparing a corporate plan for SSHRC for September 1988 was approved.

20.231 In addition, in June 1987 senior management approved the development of a coherent operational management infrastructure. In September 1987, the operations committee developed and presented a detailed working plan in support of this initiative. This project is ongoing and senior management expects that operational and human resource plans will be developed and implemented by the end of 1988.

Project Follow-up

20.232 In 1986, we recommended that management establish a follow-up system to ensure that grant projects have been completed and that any unused moneys are collected by SSHRC. In this area, progress has been made. In 1986, we reported that in 46 percent of cases reviewed complete follow-up had not been done. Our recent audit found that this percentage had declined to 18 percent.

20.233 We also recommended that, on a random selection basis, management perform a detailed review of completed projects to ensure compliance with grant agreements. In June 1986, a committee was established by Council to, among other things, review terminated major projects. As of April 1988, no review of completed projects had been done.

Results of Research

20.234 Our recommendation in this area called for senior management to provide Council with pertinent information at regular intervals on the results of research, and to make this information available to the research community and other interested parties.

20.235 Senior management considered running a pilot project to collect results of research from subsidized researchers for an initial period of one year. This information would then be added to a longitudinal data bank now under development. However, at the time of our follow-up, this project had not been initiated.

Program Evaluation

20.236 Although we made no specific recommendations in this area in 1986, we noted that the position of Co-ordinator of Evaluation was vacant. The position has now been filled.

ORGANIZATION AND PROGRAMS OF THE OFFICE OF THE AUDITOR GENERAL

ORGANIZATION AND PROGRAMS OF THE OFFICE OF THE AUDITOR GENERAL

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21

ORGANIZATION AND PROGRAMS OF THE OFFICE OF THE AUDITOR GENERAL

The Office's Organization, Process and Initiatives

21.1 The preceding chapters in this Report present a number of the Office's products – the results of its audit work. This chapter describes additional products, special initiatives and particular aspects of the way the Office works. Its intention is not to describe all the projects undertaken in the Office during the year but to highlight for Members of Parliament the major and significant developments within the organization since the publication of the last Report.

21.2 Just as the Office scrutinizes the federal government's departments and programs, it also examines and evaluates its own programs and operations with the goal of increasing the productivity of its staff and the quality of its audit work. Several initiatives this year are aimed at this goal. After the report of the Study on the Cost Effectiveness of the Audit Work of the Office described in the 1987 Report, the Office was reorganized so as to produce higher quality audits without an increase in resources. Groups within the Audit Operations Branch were rearranged, and both the mandate and resourcing levels of the Professional Practices Group and the Planning and Co-ordination Unit were expanded to reflect a heightened emphasis on these functions. The development and upgrading of audit methods through computerization were again significant. In addition, a core training curriculum was developed and put into practice, and the work of the branches reviewed by Program Evaluation and Internal Audit.

21.3 Internationally, the Office continues to make an important contribution. At the forefront of both comprehensive auditing and computer audit technology, the Office has provided assistance this year to several countries and groups of countries such as the regional groups of the International Organization of Supreme Audit Institutions (INTOSAI).

21.4 Within the Office, innovations and improvements have also been made in the areas of official languages, employment equity, recruiting audit trainees and video presentations of annual Report chapters.

21.5 These initiatives are described in more detail in the following pages.

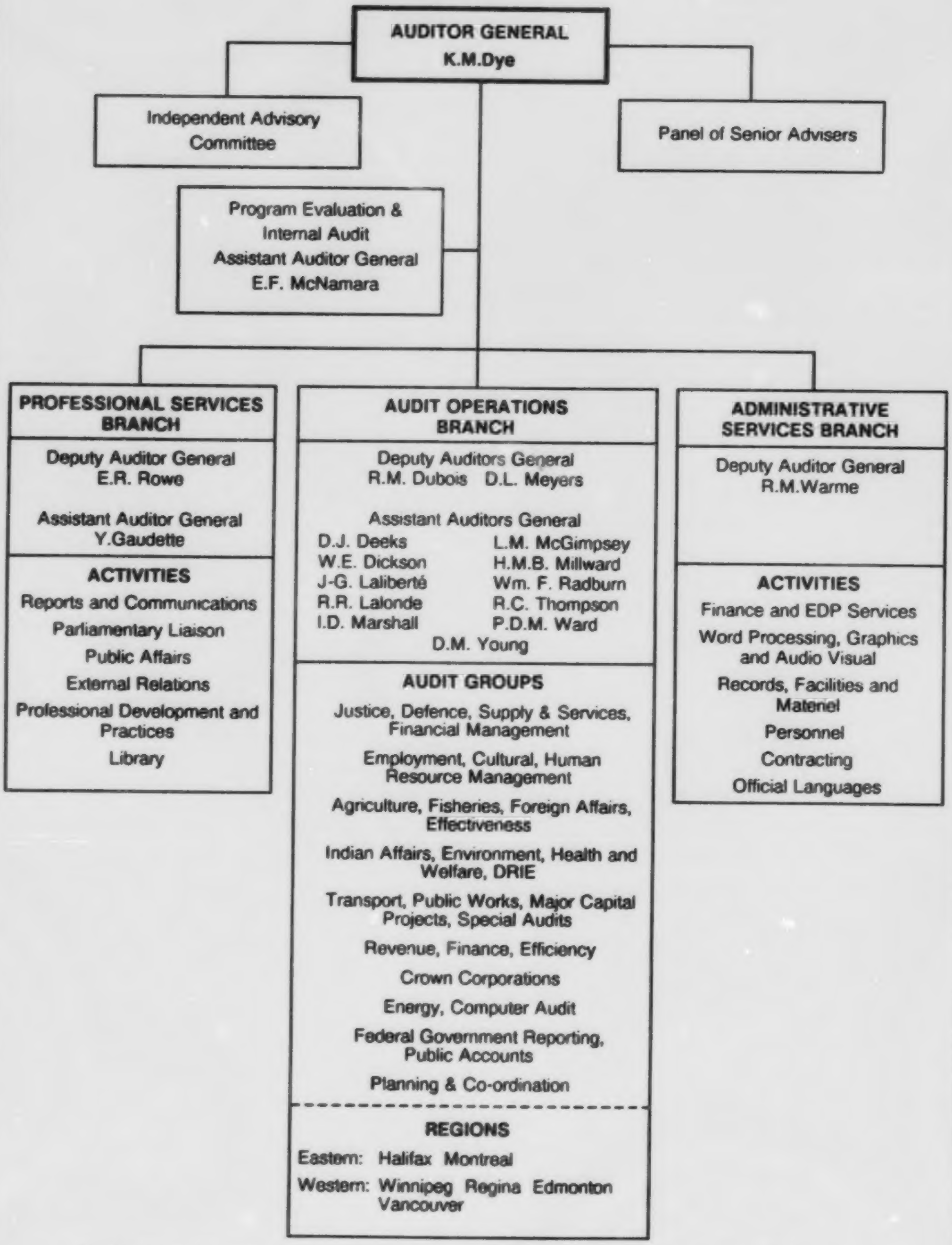
Mandate, Auditing and Reporting

21.6 **Mandate**. The legislative mandate for the activities of the Auditor General is in the Auditor General Act, 1977, and the Financial Administration Act and its 1984 amendments.

21.7 **Auditing**. Each year the Office conducts audits in all departments and agencies to enable the Auditor General to express an opinion on the summary financial statements of

Exhibit 21.1

ORGANIZATION OF THE OFFICE OF THE AUDITOR GENERAL
August 1988


AUDITOR GENERAL
K.M.Dye
Independent Advisory Committee
Panel of Senior Advisers
Program Evaluation & Internal Audit
Assistant Auditor General
E.F. McNamara
PROFESSIONAL SERVICES BRANCH
Deputy Auditor General
E.R. Rowe
Assistant Auditor General
Y.Gaudette
ACTIVITIES
Reports and Communications
Parliamentary Liaison
Public Affairs
External Relations
Professional Development and Practices
Library
AUDIT OPERATIONS BRANCH
Deputy Auditors General
R.M. Dubois
D.L. Meyers
Assistant Auditors General
D.J. Deeks
L.M. McGimpsey
W.E. Dickson
H.M.B. Millward
J-G. Laliberté
Wm. F. Radburn
R.R. Lalonde
R.C. Thompson
I.D. Marshall
P.D.M. Ward
D.M. Young
AUDIT GROUPS
Justice, Defence, Supply & Services, Financial Management
Employment, Cultural, Human Resource Management
Agriculture, Fisheries, Foreign Affairs, Effectiveness
Indian Affairs, Environment, Health and Welfare, DRIE
Transport, Public Works, Major Capital Projects, Special Audits
Revenue, Finance, Efficiency
Crown Corporations
Energy, Computer Audit
Federal Government Reporting, Public Accounts
Planning & Co-ordination
REGIONS
Eastern: Halifax Montreal
Western: Winnipeg Regina Edmonton Vancouver
ADMINISTRATIVE SERVICES BRANCH
Deputy Auditor General
R.M.Warme
ACTIVITIES
Finance and EDP Services
Word Processing, Graphics and Audio Visual
Records, Facilities and Materiel
Personnel
Contracting
Official Languages

The Executive Committee is composed of the Auditor General and the Deputy Auditors General.

the Government of Canada. Annual audits also assess departmental and agency compliance with legislative authority.

21.8 The Auditor General also conducts value-for-money audits in departments and agencies to fulfil the reporting requirements of section 7(2) of the Auditor General Act. Cases are reported where departments or agencies have made expenditures without due regard to economy and efficiency, or where satisfactory procedures have not been established to measure and report the effectiveness of programs. The Office has designed a program of audits that allows for each major entity to be given regular attention in value-for-money audits. This may take the form of an entity-focussed, program-focussed or government-wide audit. An entity-focussed audit is the broad-based comprehensive audit that examines all major value-for-money issues facing the entity. A program-focussed audit will examine the major issues facing a program within the entity, with an emphasis on results. Government-wide audits are conducted when it is feasible and appropriate to examine issues common to a number of departments. For the major departments, the Office has found that it is not cost effective to audit and report on a large number of complex programs and issues in the same year. In effect we have divided these departments into auditable units.

21.9 **Reporting**. Throughout the audit process, findings are discussed with management in the entities being audited. Matters that the Auditor General identifies as being of concern to Members of Parliament are brought together in the annual Report. An opinion – together with any reservations the Auditor General may have – is given on the Public Accounts of Canada and included in Volume I of the Public Accounts. Audits and special examinations in Crown corporations are reported to the board of directors of the corporation.

Reorganization

21.10 Exhibit 21.1 is an overview of the organizational structure of the Office, showing the functions of its three branches.

21.11 The Office has been reorganized over the past year to meet the Auditor General's concern that it function with the greatest effectiveness, efficiency and economy possible. The results of the Study on the Cost Effectiveness of the Audit Work of the Office, which he commissioned last year, provided the impetus. (For highlights of the study's recommendations and management's responses, see paragraphs 21.14, 21.15 and Exhibit 21.2.)

21.12 The major changes in the organization are the following:

- The number of audit groups has been reduced from 15 to 12.
- Functional specialists have been integrated into the audit groups.
- The Winnipeg, Regina, Edmonton and Vancouver regions have been combined to form one western region, headed by an Assistant Auditor General.
- The Halifax and Montreal regions have been combined to form an eastern region, also headed by an Assistant Auditor General.

- A separate audit group, whose responsibility is planning and co-ordinating for the Audit Operations Branch, has been established under the direction of a senior principal. This group is responsible for strategic and operational planning, and also for the human resource planning for the Branch. The intent in combining these functions is to ensure that human resource implications are examined in the context of all operational planning activities and to support staff and management in efforts to fulfil their responsibilities for career development and human resource management. The group will work closely with Personnel and Professional Development to ensure that human resource needs in Audit Operations are being effectively met (see also paragraphs 21.16 to 21.21).

- The Methodology Development Group has been provided with a new mandate and resources so that the methodology development for Audit Operations can be accelerated and enhanced (see also paragraphs 21.22 to 21.25).

21.13 The intention, in reorganizing, was to increase productivity and the quality of audits without increasing the Office's resources. In fact, the 1988-89 Estimates show planned person-years of 619, a reduction of 40 from the 1987-88 plan. During the past year, in addition to its regular program of audits, Audit Operations has completed 2 special examinations and begun work on 15 more. Integrating functional specialists with the entity groups has improved the quality of the various phases of audit work, including final reports, without increasing staff.

Study on the Cost Effectiveness of the Audit Work of the Office

21.14 In December 1986, the Auditor General commissioned a study on the cost effectiveness of the OAG's audit work. It was conducted by Stevenson Kellogg Ernst and Whinney, Management Consultants, under the direction of Kenneth G. Belbeck and members of the Auditor General's senior staff. Its objectives were to make the comprehensive auditing activities of the Office more cost effective, and to improve the general performance of the Office. Audit Operations Branch was the focus of the study; only the activities that directly affect audit work – Career and Professional Development, Professional Practices, and Program Evaluation and Internal Audit – were considered for the other branches.

21.15 The highlights of the reported observations and recommendations, and management's responses, are summarized under the main subject headings in Exhibit 21.2.

Planning and Co-ordination Unit

21.16 As part of this year's reorganization, the role of the Planning and Co-ordination Unit (PCU) was expanded. Under the direction of a senior principal, the Unit reports to the Deputy Auditors General (DAGs) of Audit Operations, and is responsible for strategic, operational and human resource planning and the co-ordination of the Branch.

Strategic, operational and human resource planning are the responsibilty of the expanded Planning and Co-ordination Unit.

21.17 **Strategic planning.** The Unit prepares two strategic planning documents – the Environmental Assessment, and Priorities for Improvement, Audit Operations. The Assessment is produced annually and identifies the major opportunities and constraints facing the Office in the foreseeable future. It provides the background to the priorities document. The priorities document gives guidance to the audit groups in establishing plans for the next fiscal year and identifies significant major management issues facing the Branch.

21.18 **Operational planning.** Each of the Audit Operations groups headed by an Assistant Auditor General (AAG groups) is responsible for its own planning and the implementation of its plans. The PCU co-ordinates to ensure that the plans are consistent and that inter-group and inter-branch issues are considered. It consolidates the individual group plans into the Branch plan and provides advice to the DAGs on the plans. The AAG groups prepare a multi-year plan of the value-for-money audits and special examinations they expect to undertake. The group plans are summarized for the Executive Committee. The Unit then organizes challenge review sessions at which the DAGs discuss the budget details with the AAGs and the Principals. These lead to resource allocation decisions by the DAGs.

21.19 Throughout the year the PCU is actively involved in monitoring the implementation of the plans and recommending resources to meet the needs of the Branch.

STUDY ON THE COST EFFECTIVENESS OF THE AUDIT WORK OF THE OFFICE

SUBJECT	OBSERVATIONS/ RECOMMENDATIONS	MANAGEMENT'S RESPONSE
Planning for Operations	The Office of the Auditor General should enhance the planning function in Audit Operations to provide additional strategic input into determining future directions, especially the nature, frequency and choice of value-for-money audits. There is a parallel need for a stronger human resource planning function in Audit Operations. An Assistant Auditor General would be an appropriate leader of the combined function.	The Deputy Auditors General of Audit Operations have appointed a senior Principal to head the Planning and Co-ordination Unit on a full-time basis. This unit will also be responsible for co-ordinating human resource planning for Audit Operations. The Principal will draw on the Branch's resources to implement the planning mandate and avoid a costly and bureaucratic superstructure. This position will be part of the normal rotation of Principal assignments within Audit Operations and will be filled for a period of two or three years. Principals selected will be active audit practitioners who the DAGs believe will have the confidence of the Branch in co-ordinating the Branch-wide issues.
Attest Audits	In reviewing the cost-effectiveness aspects of attest auditing, the study team noted innovations by members of the Office that reduced audit costs without impairing audit quality. The Office should adopt an agreed-upon planning approach that allows for more attention to be paid to making the best choices and trade-offs for each audit.	Audit hours for attest audits are now challenged more rigorously. The revised version of the Comprehensive Auditing Manual will outline clearly an overall approach to planning for cost-effective attest audits. Audit teams are encouraged to experiment with new techniques to improve cost effectiveness and communicate their findings through the Professional Practices Group. Professional Development will make courses available to help audit professionals plan and conduct attest audits more cost effectively
Value-for-money Audits	Value-for-money audits have tended to concentrate on getting the best quality results. A concern for cost effectiveness will place a higher priority on economical work. The study team recommended refining the concept of audit scope, reducing the hours and elapsed time for scoping audits, and shortening the execution time.	Although there is general agreement with the thrust of the recommendations, there is a considerable range of views in the Office on their specific application. The suggested maximum scoping time of eight weeks was regarded by many senior managers as unrealistic, although there is an agreed need to do it more efficiently. The Professional Practices Group has been asked to study the issues and make recommendations to the Audit Operations Branch leading to new scoping methodology for the Manual. The suggestion that audits focus on fewer issues but in more depth was included in the 1988-89 priorities document for Audit Operations which gives direction to the audit teams. Teams are asked to focus on four or five major issues within the scope, and chapter length has been set at a maximum of 20 pages, which may only be exceeded with Executive Committee approval. The recommendation to shorten the elapsed time for audits is accepted in principle. But experience and a detailed review of the 1987 Report chapters led to the conclusion that audits should begin 18 months before the reporting date rather that 12 months, as recommended in the report. Although it is agreed that unproductive lines of audit inquiry should be cut off, it is a difficult decision for the AAG and the audit Principal. The Annual Report Steering Committee will advise the AAG and the Principal if they believe the line of inquiry to be unproductive. In addition, revised guidelines on unproductive lines of inquiry will be incorporated in the Comprehensive Auditing Manual.

Exhibit 21.2

STUDY ON THE COST EFFECTIVENESS OF THE AUDIT WORK OF THE OFFICE

SUBJECT	OBSERVATIONS/ RECOMMENDATIONS	MANAGEMENT'S RESPONSE
Audit Policy & Methodology	At present, development and dissemination of audit policy and methodology are dispersed, and output tends to be slow. The role of the Professional Practices Group should be changed from co-ordinator to developer, under the leadership of a strong and dedicated Assistant Auditor General.	The Office has restructured the methodology development process. The Methodology Development Committee has been reorganized, under the chairmanship of the Auditor General himself, an operational framework established and methodology development priorities set (see also paragraphs 21.22 to 21.25).
Use of Outside Professionals	The Office might use outside professionals to achieve increased cost effectiveness in auditing by experimenting with greater use of fixed-price contracts or with contracting-out of some attest audits in their entirety.	Management will experiment with the use of fixed-price contracts and then evaluate the experience. Fixed-price contracts will be established only when there is clearly a complete product which can be specified in advance. Entire attest audits may be contracted out with Executive Committee approval where there is an opportunity and desire to do so.
Professional Development	Professional Development costs per trainee day have been rising as the demand for training has declined – against a more or less fixed budget. Anticipated training requirements should be readdressed and budgets prepared accordingly.	The Professional Development Group is addressing this issue. It is developing a core training program based on the recommendations of the Task Force on Knowledge and Skills, which set out a model for skills and experience to be required or encouraged throughout the career of professional legislative auditors.
Overhead Expenditures	Although the basic data are captured by the Office's accounting system, regular reports are not prepared on the Audit Operations Branch's overhead expenditures. These expenditures should be budgeted, challenged and reported on.	This recommendation prompted a renewed interest in ensuring that the Audit Operations Branch is getting value for money on overhead expenditures. Audit groups' external project budgets are now documented with a clear statement of the intended output, and will be closely monitored by Planning and Co-ordination. In addition, a newly designed report, which clearly identifies the Branch's overheads, came into effect in April 1988.
Functional Specialists	Functional specialists should be positioned within audit groups, and the number of audit groups should be reduced by two.	As recommended in the study, the functional specialists have been absorbed into audit groups. The number of audit groups has been reduced from 15 to 12.
Management Information Systems	The study did not include a review of management information systems, but in examining other matters, areas were observed in which system enhancements would benefit the users. These enhancements should be made.	Several actions have been taken to improve management information: project-to-date costs are now provided; audit project costs are summarized on a regular basis; branch overheads are clearly identified and reported by item and group; project costs are being reclassified into a list of standing accounts.

21.20 **Human resource planning**. Because human resources make up 85 percent of the Office's resources, assignment to audit teams and the overall placement of people in the Office are most important. The Unit works closely with Personnel and Professional Development to attract, train and retain Audit Operations staff. Assignment planning and career counselling are of critical importance. Special needs for auditors outside the Branch must be considered; in particular the Professional Development and Practices Group needs people with audit experience to work in training and methodology development and to support the Office's international projects.

21.21 The PCU co-ordinates various activities related to human resource management and Branch administration to ensure that a consistent approach is being followed.

Methodology Development

21.22 During the past year, the Office has placed renewed emphasis on the way it develops, tests and disseminates its audit process and procedures – methodology. A number of factors influenced the decision to do so, including:

- recognition of the need to capture the lessons learned in almost 10 years of comprehensive auditing (this need was confirmed by the recommendations of the Study on the Cost Effectiveness of the Audit Work of the Office – see paragraphs 21.14, 21.15 and Exhibit 21.2); and
- a desire to shape the future evolution of comprehensive auditing so that it continues to meet the expectations of legislators and reflect changes in government accountability and management structures.

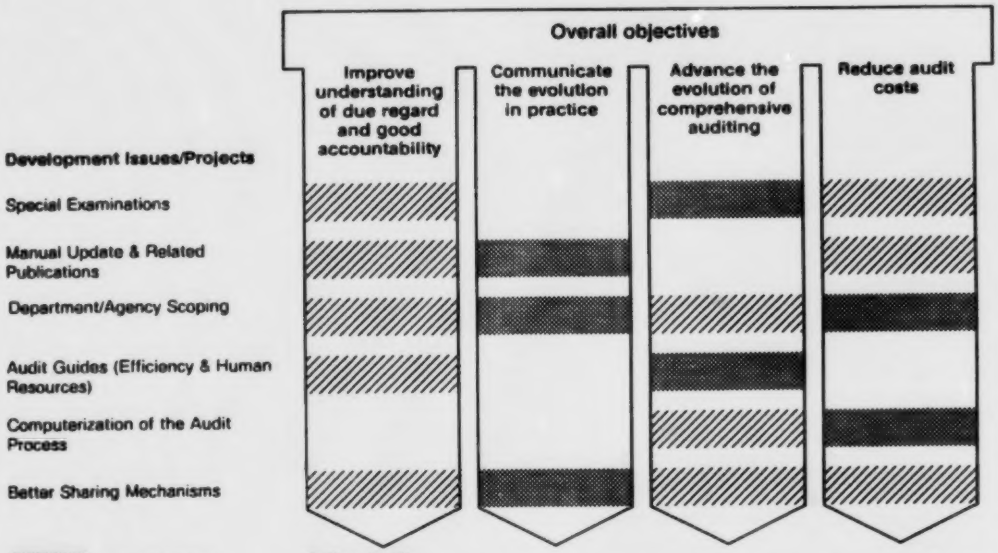
21.23 To implement this decision, a number of key steps have been taken. The Methodology Development Committee has been restructured as a small decision making, user-oriented committee. It will provide high level direction, oversight and support. The Committee is chaired by Auditor General Ken Dye with Deputy Auditor General Ed Rowe acting as alternate Chairman. Membership includes Raymond Dubois and Larry Meyers – Deputy Auditors General of Audit Operations – two Assistant Auditors General and two senior Principals. The Committee is supported by the Professional Practices Group under Assistant Auditor General Yvan Gaudette.

21.24 To date, the Committee has established a methodology development plan and priorities and an operational framework (see Exhibit 21.3). The operational framework has the following objectives for methodology development over the next three to five years:

- to better articulate and explain what represents good accountability and due regard;
- to reflect practical experience in our methodology and communicate the evolution that has taken place in practice;
- to advance the evolution of comprehensive auditing to reflect changes in government accountability and management structures; and
- to find ways to reduce audit costs.

Exhibit 21.3

METHODOLOGY DEVELOPMENT FRAMEWORK
How projects relate to overall objectives



Development Issues/Projects	Overall objectives: Improve understanding of due regard and good accountability	Communicate the evolution in practice	Advance the evolution of comprehensive auditing	Reduce audit costs
Special Examinations	▨		■	▨
Manual Update & Related Publications	▨	■		▨
Department/Agency Scoping	▨	■	▨	■
Audit Guides (Efficiency & Human Resources)	▨		■	
Computerization of the Audit Process			▨	■
Better Sharing Mechanisms	▨	■	▨	▨

■ Primary Impact

▨ Secondary Impact

Office goals:

- **Better accountability, prudence and probity in the use of public money**
- **Office leadership in comprehensive auditing**

21.25 In pursuit of these objectives, the Committee has identified the following priority areas for development. Terms of reference and work plans have been approved, or are in process, for

- updating the Office's Comprehensive Auditing Manual to reflect current practice;
- methodology for special examinations;
- developing and testing guidance on scoping of departmental and agency value-for-money audits;
- computerization of the audit process; and
- completion or revision of certain guides dealing with application of the comprehensive auditing concept in specific situations.

Financial Resources

21.26 Parliamentarians now have available to them, in Part III of the Estimates of the Government of Canada, the detailed resource requirements of the Office of the Auditor General.

21.27 Exhibit 21.4 provides an overview of appropriations and expenditures by activity.

Information Technology

21.28 1987-88 was the final year of the three-year special EDP initiative outlined in the Office's 1984-85 Estimates. The period has been one of intense activity and change as the Office has geared up to meet the challenge of technology. The number of personal computers has grown to 550 from the 23 in the Office in 1984. Computer programs were used to access financial data on government mainframes at that time, and both the word processing and graphics units were state-of-the-art.

21.29 The first step in the three-year initiative was to prepare a plan. Its first objective was to help audit staff understand the risks and control techniques which apply to the hundreds of mainframe computer systems used in government. A second objective was to harness technology to enable auditors to work better and reduce audit costs.

21.30 Some of the milestones have been reported in the 1986 and 1987 Reports. The Auditor Trainee program each year provides selected line auditors with a one-year intensive upgrading in computer controls and techniques before they return to regular audit duties. Interactive Data Extraction and Analysis (IDEA), which helps auditors to use microcomputers as powerful analytical tools, has now been adopted not only in the Office but throughout the world. The move to laptop computers has enabled auditors to apply technology directly at client locations. And electronic communications have been developed.

21.31 Today in the Office there are some 550 microcomputers – one for almost every staff member. Approximately 320 of these are laptops. There are several significant developments, in addition to those mentioned above, which have changed the nature and practice of audits, communications and administration in the office. Both in Audit Operations and in the other branches, advantages of technology have been exploited aggressively.

21.32 **Text retrieval.** Text retrieval techniques have been brought to the auditor's laptop computer to permit the searching of large quantities of text such as statutes, regulations and reports quickly and efficiently.

21.33 **Communications.** The Office now has some 324 users of electronic mail, which is a routine means of communicating both at headquarters and between audit sites anywhere in Canada or throughout the world. Electronic bulletin boards have been established which allow auditors to exchange documents for information or for comment and review.

21.34 **ReportRead:** Those involved in writing chapters for the annual Report, together with the Auditor General and Deputy and Assistant Auditors General and other reviewers of chapters, are now able to access the Report electronically as it develops – in the Office, at home or on the road. ReportRead, which links into individuals' microcomputers, has eliminated much of the photocopying and distribution of hard copies of the chapters and is greatly facilitating the process of review.

Exhibit 21.4

OFFICE OF THE AUDITOR GENERAL OF CANADA
APPROPRIATIONS AND EXPENDITURES

Appropriations and Expenditures by Activity

(thousands of dollars)

	1988-89	1987-88		1986-87	
	Estimates	Appropriations	Expenditures	Appropriations	Expenditures
Legislative Auditing	48,337	47,046	45,644	44,982	44,210
TOTAL	48,337	47,046	45,644	44,982	44,210

Appropriations and Expenditures by Object

(thousands of dollars)

	1988-89	1987-88		1986-87	
	Estimates	Appropriations	Expenditures	Appropriations	Expenditures
Salaries and Wages	29,644	29,931	26,811	28,663	26,489
Contributions to Employee Benefit Plans	4,513	4,748	4,748	4,377	4,377
Transportation and Communications	2,920	2,918	2,969	2,918	2,945
Information	238	273	248	273	277
Professional and Special Services	7,050	6,659	6,052	6,960	7,062
Rentals	300	262	359	262	334
Purchased Repair and Upkeep	396	296	279	296	376
Utilities, Materials and Supplies	661	350	1,010	350	636
Capital-Construction or Acquisition of Machinery and Equipment	2,133	1,149	2,708	438	1,268
Transfer Payments	472	450	449	435	434
All Other Expenditures	10	10	11	10	12
TOTAL	48,337	47,046	45,644	44,982	44,210

Approximately 60 percent of the Office's micro-computers are portable laptops.

21.35 **Electronic briefcase.** The Office has developed and tested a new micro-based system, AUDITPRO, which enables auditors to complete an entire assignment using the computer. Many types of software can be linked to AUDITPRO, and auditors can create and keep track of an entire audit file electronically. This system is expected to save hundreds of audit hours and result in significant quality and effectiveness improvements over the next few years.

21.36 **Public Accounts audit system.** This micro-based system allows auditors to independently prepare consolidated financial statements for the Government of Canada within days after the underlying detail has been made available. It is used both to check the accuracy of the Public Accounts presented to the Office for audit and to keep track of the hundreds of adjustments made to the Accounts before they are finally published.

21.37 **Administration and financial control.** During the past few months, a prototype of an on-line financial and operational control system has been completed. It allows managers to obtain up-to-date information on costs and trends for all the work conducted by the Office. The system presents results on a screen, both numerically and graphically. It is designed to respond to questions as they arise rather than to produce quantities of computer printout, which are hard to decipher.

AUDITPRO helps auditors create and keep track of audit files electronically.

Core Training Curriculum

21.38 In May 1987, the Audit Operations Task Force on Knowledge and Skills published a report which has become an important instrument in human resource planning. The Professional Development and Practices Group has developed a curriculum of courses to provide training for auditors in most of the core knowledge and skills requirements it identified.

21.39 The Task Force Report and Training Curriculum are both important means of ensuring that we have highly qualified professional staff who produce audits of the highest standards.

Program Evaluation and Internal Audit

21.40 The Program Evaluation and Internal Audit Group has three principal objectives. Through program evaluation, it assesses the effectiveness of the Office's audit activities in support of the scrutiny role of the House of Commons. Through post-audit quality review, it assesses whether the Office selects only matters of significance for audit, and audits these in a professional and cost-effective manner. Through internal audit, it assesses whether important management practices and procedures throughout the Office reflect due regard for value for money.

21.41 The following is a summary of the work carried out by the Program Evaluation and Internal Audit (PEIA) Group during the past year.

21.42 **Program evaluation.** An evaluation is under way which involves asking for the views of the principal audiences for the Office's annual Report. PEIA is contacting Members of the House of Commons and the Senate, ministers and their deputies, heads of Crown corporations and a cross section of journalists, looking for assurance that the Office is reporting the right issues and reporting on them right. The project also includes a follow-up of PEIA's 1985 evaluation of the annual reporting process (paragraphs 15.81 to 15.88 of the 1985 Report).

21.43 **Post-Audit Quality Review (PAQR).** Post-audit quality reviews are performed annually on a sample of the Office's audit work.

21.44 **Departmental comprehensive audits.** The 1987 Report described the PAQR assessment of the shift from systems-based audit approaches to those based more on program results. There were variations, but a general shift toward results-based auditing was evident, and some positive characteristics of those audits were noted.

21.45 The recommendations contained in that report have sparked lively and productive debate within the Office about what issues should or should not be included in a value-for-money audit. The Methodology Development Committee is paying particular attention to resolving this problem, as it is now completing revisions to the Comprehensive Auditing Manual.

21.46 Work is under way on studies of:

- the use that is being made of Audit Advisory Committees in the Office, and
- the reliance that the Office should be placing on the internal audit groups in "client" departments and agencies, and in Crown corporations.

The results of these studies will be reported in 1989.

21.47 **Crown corporations, other entities and the Public Accounts of Canada.** During the year, PEIA reviewed the audits of 8 Crown corporations and other entities and 10 Public Accounts audits. The review noted compliance with generally accepted auditing standards and with those of the Office. During 1988-89 the PEIA Group will identify exemplary cases of audit teams significantly improving their audit efficiency and describe how they did it.

21.48 **Internal Audit.** In the previous two years all major administrative, personnel and financial management systems of the Office were examined. A respite seemed appropriate this year to allow time for the Office to consider and implement the recommendations made.

The International Scene

21.49 Because of the reputation of the Office as a leader in comprehensive and legislative auditing, and in computer assisted auditing, it is often called upon to share its expertise with other countries, especially developing countries and others which are seeking to strengthen their capacities in governmental auditing. Several projects undertaken in 1987 exemplify the contribution the Office has made on the international scene.

The XIIIth Conference of Commonwealth Auditors General

21.50 The Office of the Auditor General hosted the XIIIth Conference of Commonwealth Auditors General which took place from 28 September to 2 October 1987 in Ottawa. This was the first time the triennial conference had been held in Canada. Essentially a forum for exchanging ideas, experiences and trends in auditing, it has no established mandate but is vital for reinforcing the principles of independent legislative auditing.

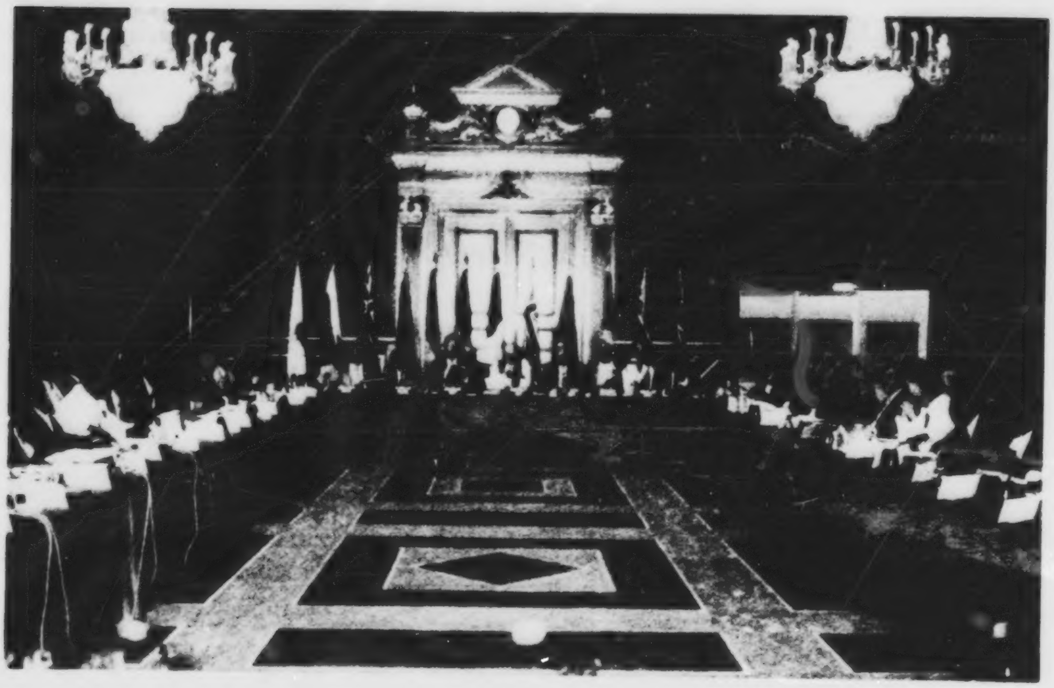
21.51 The title of the conference was Advancing Accountability: Practice, Perception and Predictions. As conference chairman, Ken Dye welcomed the delegates to the opening session and outlined the following agenda for the week: the role of the Auditor General in public accountability; the role of the public accounts committee in advancing accountability; planning and managing resources in a changing environment; training strategies for sharing knowledge and experience; developments in computer auditing; audit of capital projects and social programs; and improving financial information for parliamentarians.

21.52 All delegates participated in high-level discussions pertaining to legislative auditing – from such fundamentals as the need for the independence of the auditor to be defined by statute all the way to the latest developments in information technology.

21.53 The Ottawa conference had the greatest number of participants in the history of the Conference of Commonwealth Auditors General. The 71 delegates from 44 countries came from diverse backgrounds. Many represented industrialized nations with established audit offices and active public accounts committees (PACs). Other delegates came from small developing countries where there are difficulties in recruiting and maintaining skilled auditors, and problems arise because their PACs meet too infrequently. However, throughout the sessions, emphasis on common principles proved far more important than any dissimilarities.

The International Audit Office Assistance Program

21.54 Since 1980, a fellowship program funded by the Canadian International Development Agency and administered by the Canadian Comprehensive Auditing Foundation continues to bring senior auditors from developing countries to work and study in the Office of the Auditor General. In 1987-88, seven international fellows were funded from the following countries: Colombia, Indonesia, Korea, Mexico, Morocco, Sri Lanka, and Tunisia. Two other fellows, one from Hong Kong and one from Singapore, were funded by their own countries.



The XIIIth Conference of Commonwealth Auditors General, held in Ottawa, was attended by 71 delegates from 44 countries.

21.55 The fellows spend one year with the OAG, assisting in a variety of audit areas and enhancing their knowledge and understanding of public sector accounting and auditing, especially the value-for-money segment. As well as gaining practical experience by working with audit teams, they also participate in a number of professional development activities. The knowledge and experience they gain assists them in improving their audit work when they return to their home environment.

Sino-Canadian Auditor Training Project

21.56 Since 1982, the Office of the Auditor General has been involved in an international effort, first with the United Nations and then with the Canadian International Development Agency (CIDA), to assist the People's Republic of China in developing the legislative audit function required by its new constitution.

21.57 The main objective of the first phase of the project carried out for CIDA was to train Chinese auditors in the concepts, methods and skills practised in Canada. A secondary objective was to train a core of qualified audit instructors who could establish an appropriate training capability in the Audit Administration of the People's Republic of China (AA/PRC).

21.58 The first phase of the project will be completed by December 1988. It is expected that all the major planned outputs will either be achieved or exceeded and that the project will be delivered within budget. The OAG will have provided, as an agent of CIDA during that time, the necessary professional, technical, and administrative support to fulfil both project objectives.

21.59 Both the Canadian and Chinese governments view the first phase as a success. They are now considering a second phase. In addition to reinforcing the internal training carried out in Phase I, Phase II could address audit education at university and college levels as well as related research activities.

21.60 For the OAG, the project has provided audit staff with exposure to a different and fascinating culture and to different accounting and auditing concepts. It has served as an excellent training opportunity, especially for staff involved in the audit of Canadian international programs.

Other International Projects

21.61 Office staff have provided training, advice and assistance in the Republic of Cyprus, the Eastern Caribbean and NATO this past year. At the request of the United Nations, OAG staff members delivered courses in comprehensive auditing in Cyprus, provided advice to the Auditor General on the planning, implementation and reporting of performance audits, and installed our Interactive Data Extraction and Analysis software on the Cyprus Audit Office's computer. At the request of CIDA, two of the Office's senior staff members conducted a course in comprehensive auditing for 32 legislative auditors representing 8 member states of the Organization of the Eastern Caribbean States as part of the Eastern Caribbean Economic Management Program. At NATO, Deputy Auditor General Ed Rowe has been advising and assisting the Canadian Mission on the revision of the audit structure and process.

The INTOSAI Development Initiative

21.62 At the twelfth congress of the International Organization of Supreme Audit Institutions (INTOSAI), the proposal to establish formally the INTOSAI Development Initiative (IDI) was adopted. It had been proposed by the Auditor General of Canada to the Governing Board of INTOSAI in 1985 and accepted in principle.

21.63 The mission of IDI is to foster the advancement of public accounting and auditing, especially in developing nations. This is to be done through information exchange and training for audit practitioners and trainers of Supreme Audit Institutions (SAIs).

21.64 In its first two years, IDI has focussed on the internal training needs of SAIs, identified through regional training needs assessments by the IDI Advisory Committee and staff of participating countries. In 1987 these needs assessments were conducted in all INTOSAI regional groups and in the Caribbean.

Office staff conducted a comprehensive auditing course for the Organization of the Eastern Caribbean States.

21.65 Based on the results of the training needs identification, the focus in 1987 has been (and for the next two years will continue to be) on human resource management seminars for the executive officers of SAIs, training managers' workshops for those responsible for the training function in SAIs and audit workshops for various levels of audit staff.

21.66 Workshops in several disciplines have been piloted and delivered by IDI in various centres around the globe: a training needs analysis workshop in Kenya; training managers' workshops in Tanzania and in Kenya; human resource management workshops for heads and deputy heads of SAIs in the Philippines, Jordan and Gabon; an audit workshop in Thailand; and a micro-computing workshop in Copenhagen. Senior staff from the Office participated in the design and delivery of all these workshops.

21.67 In addition, IDI has produced the International Directory of Information for Audit Training, now available in English, French, Arabic and Spanish, with the German translation to be ready shortly. The Directory contains course designs and case study outlines provided by some 15 countries as well as a list of audit methodologies and a list of non-profit audit training institutions.

21.68 Funding for IDI is provided by CIDA, the United Nations Development Program, Royal Norwegian Ministry of Development Co-operation, United States Agency for International Development, Japan International Co-operation Agency and Commonwealth Secretariat.

21.69 The IDI Office was located in Canada's OAG for 1987 and 1988. The Auditor General of Canada is the President of the eight-member IDI Board, one of the Deputy Auditors General is Secretary-Treasurer, and an Assistant Auditor General is Executive Vice-President.

The language training program increases the Office's level of functional bilingualism.

Official Languages in the OAG

21.70 The Office of the Auditor General strives to fully reflect in its day-to-day operations the three basic principles relating to language of service, language of work, and equitable representation of the two official language groups, which continue to guide the government's official languages policies in the public service. To this end, it maintains bilingual resources that allow it to communicate with members of the public in the official language of their choice, to conduct audits in English or French as required, and to provide employees with equal opportunities to perform their duties in the official language of their choice. Efforts are also made to maintain an equitable overall representation of the two official language groups in the Office.

21.71 Early in 1987 the Executive Committee approved an Official Languages Plan for 1987-88. It includes objectives and specific goals, with a schedule of planned activities and submission of a semi-annual report to the Executive Committee. The Commissioner of Official Languages recently noted that the OAG "has made considerable progress with respect to the overall management of its official languages program".

Audit Trainee Program

21.72 The Office of the Auditor General plays an important role in the accounting profession by training students preparing to become Chartered Accountants, Certified General Accountants, and Certified Management Accountants. The Office articles some 20 new students each year, providing them with the experience they need to obtain their accounting designations. In 1987-88 the Office hired university graduates from across Canada to work full-time in its various offices.

21.73 Selection of candidates for this full-time Audit Trainee Program has been facilitated through increased use of the co-operative study-work programs offered by some Canadian universities. After working for several four-month terms with the Office, students in these programs are considered for full-time employment as audit trainees.

A Principal, left, discusses an assignment with a new audit trainee.

21.74 In addition, the Auditor General takes advantage of Employment and Immigration's Career Oriented Summer Employment Program (COSEP) to select students to work in auditing. Summer students who are properly qualified and interested in permanent employment with the OAG are then recruited to work as full-time audit trainees after graduation.

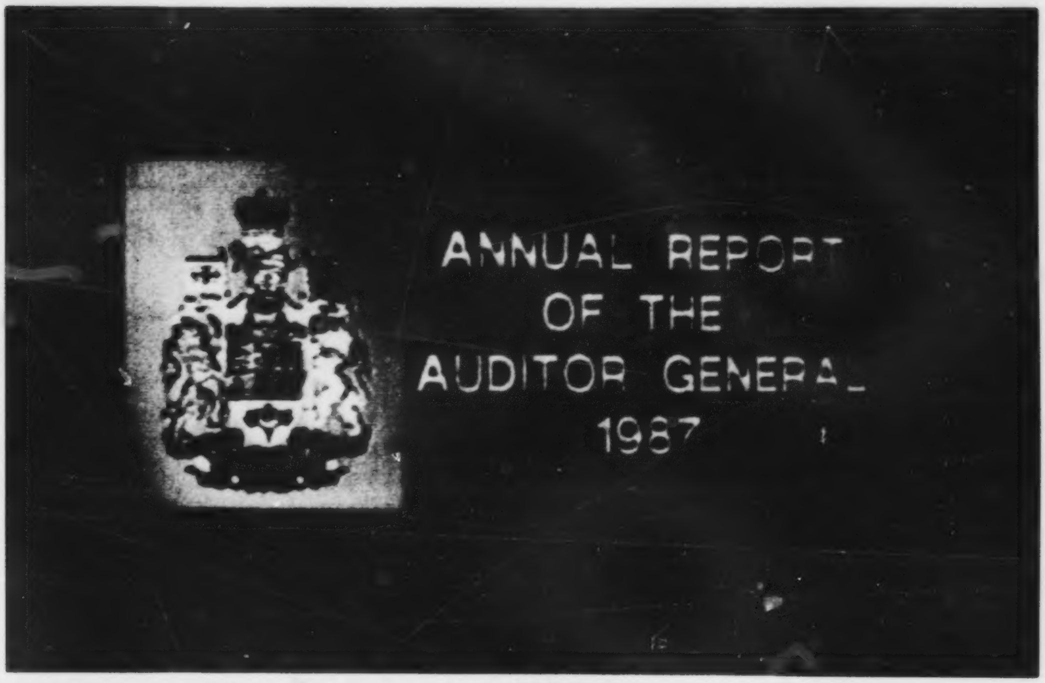
21.75 The Office has recently published a brochure describing its audit trainee program, and continues in its search for the best candidates to work in this unique environment of legislative auditing.

Video Presentation of Annual Report Chapters

21.76 In 1986 the OAG produced a 10-minute videotape of one annual Report chapter – the Veterans' Affairs Portfolio – as a pilot project. As the members of the Public Accounts Committee and other Members of Parliament who saw it responded positively, the decision was made to produce seven videotape presentations of annual Report chapters in 1987. These set out findings from the Financial Management and Control Study, audits of the Departments of National Health and Welfare and National Defence - Materiel Support and three Special Audits, and the Auditor General's Opinion and Observations on the Financial Statements of the Government of Canada. The videotapes were made available to all Members of Parliament through the OASIS network and could be accessed easily at MPs' convenience. The Office, with co-operation from OASIS, is now assessing the effectiveness of this use of videotapes. Meanwhile, they have been in demand by departments, universities, provincial auditors general and other national audit offices.

Working Group on Employment Equity

21.77 In 1983 the Office of the Auditor General created a Working Group on the Employment of the Handicapped and adopted an official policy promoting the hiring of the handicapped. Actions were undertaken to reduce the barriers to employment identified in a study, to select suitably qualified handicapped persons and to facilitate their employment.



Videotape presentations were made of seven 1987 audits.

Since 1983 the participation rate of handicapped persons in the Office has substantially increased. The Working Group was expanded this year to become the Working Group on Employment Equity, and its work will extend to equality of access to employment and opportunities in the Office for women, aboriginal peoples and visible minorities as well as the handicapped.

Costs Incurred in Preparing Reports of Audits and Special Examinations in Crown Corporations

21.78 Section 149(2) of Part XII of the Financial Administration Act (FAA) requires that, where the Auditor General of Canada is the auditor or examiner of a Crown corporation, the costs incurred in preparing any report under sections 139 and 143 shall be disclosed in his next annual Report and be paid out of the moneys appropriated for his Office.

21.79 The costs reported here pursuant to section 149(2) represent the full costs incurred by the Office in carrying out the audit and special examination work and preparing particular reports under section 139 or 143 of the FAA. These costs are reported here only when the work has been completed.

Exhibit 21.5

COSTS OF PREPARING ANNUAL AUDIT REPORTS FOR FISCAL YEARS ENDING ON OR BEFORE 31 MARCH 1988

Crown Corporation	Fiscal Year Ended	Cost Incurred
Atlantic Pilotage Authority	31.12.87	$ 54,900
Atomic Energy of Canada Limited	31.03.88	355,000
Canada Deposit Insurance Corporation	31.12.87	377,000
Canada Development Investment Corporation (Joint Auditor)	31.12.87	18,700
Cartierville Financial Corporation Inc.	31.12.87	5,100
Canada Harbour Place Corporation	31.03.88	43,000
Canada Lands Company Limited	31.03.88	14,800
Canada Lands Company (Le Vieux-Port de Montréal) Limited	31.03.88	60,800
Canada Lands Company (Mirabel) Limited	31.03.88	102,200
Canada Lands Company (Vieux-Port de Québec) Inc.	31.03.88	57,400
Canada Museums Construction Corporation Inc.	31.03.88	81,800
Canada Post Corporation (Joint Auditor)	31.03.88	301,800
Canadian Commercial Corporation	31.03.88	97,000
Canadian Dairy Commission	31.07.87	198,600
Canadian Livestock Feed Board	31.03.88	45,400
Canadian National (West Indies) Steamships Limited	31.12.87	3,000
Canadian Patents and Development Limited	31.03.88	29,900
Canadian Saltfish Corporation	31.03.88	144,500
Defence Construction (1951) Limited	31.03.88	88,300
Export Development Corporation	31.12.87	467,800
Farm Credit Corporation	31.03.88	258,600
Freshwater Fish Marketing Corporation	30.04.87	153,000
Great Lakes Pilotage Authority, Ltd.	31.12.87	49,500
International Centre for Ocean Development	31.03.88	85,300
Laurentian Pilotage Authority	31.12.87	116,200
National Capital Commission	31.03.88	156,600
Northern Canada Power Commission	31.03.88	189,700
Pacific Pilotage Authority	31.12.87	55,200
Royal Canadian Mint	31.12.87	353,900
The St. Lawrence Seaway Authority	31.03.88	103,500
Seaway International Bridge Corporation Ltd	31.12.87	17,900
The Jacques Cartier and Champlain Bridges Incorporated	31.03.88	71,800
Standards Council of Canada	31.03.88	35,200

21.80 The total costs of Crown corporations work include costs incurred on work not specifically required under section 139 or 143; for example, work in relation to issuing prospectuses, advising on information and internal control systems, and helping to resolve accounting issues and to prepare financial statements. The costs incurred for this work are not reported in this chapter.

Annual Audits

21.81 Under section 139 of the FAA, each parent Crown corporation is required to have an annual auditor's report prepared, in respect of itself and its wholly-owned subsidiaries, on the financial statements and on any quantitative information that the Treasury Board requires to be audited. Also, the auditor must prepare such other reports as the Governor in Council may require.

21.82 Exhibit 21.5 shows the costs incurred in performing the completed audits and preparing the annual auditor's reports required by section 139 for those corporations and subsidiaries audited solely or jointly by the Auditor General of Canada. The costs refer to the completed annual audits for fiscal years ending on or before 31 March 1988.

21.83 The costs reported do not include any costs for the audit of quantitative performance information, because no such audits have been requested by the Treasury Board for any of the corporations the Office audited. Similarly, there were no other reports required by the Governor in Council under section 139.

Special Examinations

21.84 Section 143 of the Financial Administration Act requires each parent Crown corporation named in Schedule C of the Act to cause a special examination to be carried out in respect of itself and, if applicable, its wholly-owned subsidiaries, at least once every five years. As the legislation came into effect on 1 September 1984, the first cycle of special examinations is to be completed by 1 September 1989.

21.85 The aim of these examinations is to determine whether, in the period under examination, the financial and management control and information systems and management practices of the corporation were maintained in a manner that provided reasonable assurance that:

- assets were safeguarded and controlled;
- financial, human and physical resources were managed economically and efficiently; and
- operations were carried out effectively.

21.86 At the completion of a special examination, a report on the findings is submitted to the board of directors of the corporation. In the case of corporations named in Part I of

Schedule C or their wholly-owned subsidiaries, the legislation provides for the examiner to draw matters to the attention of Parliament if necessary.

21.87 Where, in the examiner's opinion, the special examination report contains information that should be brought to the attention of Parliament, the examiner must, after consulting the board of directors and the appropriate minister, prepare a report on the information for inclusion in the corporation's next annual report. Where an auditor other than the Auditor General of Canada is the examiner, he or she must also consult with the Auditor General and furnish him with a copy of the report on these matters.

21.88 In 1987-88, two special examinations were completed. The costs of these examinations were:

Great Lakes Pilotage Authority	$137,300
National Capital Commission	597,800

A further 15 special examinations were in progress in Crown corporations that are audited by this Office. Costs of these will be reported in future years, as they are completed.

Advisers to the Auditor General

Membership of the Panel of Senior Advisers

Kenneth G. Belbeck, F.M.C.
Stevenson Kellogg Ernst & Whinney

Gordon H. Cowperthwaite, F.C.A.
Canadian Comprehensive Auditing Foundation

Alan J. Dilworth, F.C.A.
Touche Ross & Co.

William A. Farlinger, F.C.A.
Clarkson Gordon

Kenneth S. Gunning, F.C.A.
Pannell Kerr MacGillivray

Ralph W. Karthein, C.A.
IBM Canada Ltd.

Giles R. Meikle, F.C.A.
Deloitte Haskins & Sells

Edward W. Netten, F.C.A.
Price Waterhouse Management Consultants

Donald H. Page, F.C.G.A.
Midland Doherty Ltd.

Kenneth R. Stevenson, F.C.A.
Coopers & Lybrand

T. Robert Turnbull, F.C.A.
Thorne Ernst & Whinney

W. Ross Walker, F.C.A.
Peat Marwick

Membership of the Independent Advisory Committee to the Auditor General on Government Accounting and Auditing Standards

Morley P. Carscallen, F.C.A.
Coopers & Lybrand

L. Denis Desautels, F.C.A.
Clarkson Gordon

Kenneth M. Dye, F.C.A. (Chairman)
Auditor General of Canada

James L. Goodfellow, F.C.A.
Touche Ross & Co.

Douglas D. Graham, C.A.
Pannell Kerr MacGillivray

John J. Kelly, C.A.
Canadian Institute of Chartered
Accountants

Ronald E. Kiggins, C.A.
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David Kirkwood
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Arthur Andersen & Co.

George F. Windsor, B. Eng., LL.B.
Osler, Hoskin & Harcourt

APPENDIX A

AUDITOR GENERAL ACT

25-26 ELIZABETH II

CHAPTER 34

An Act respecting the office of the Auditor
General of Canada and matters related
or incidental thereto

[Assented to 14th July, 1977]

Her Majesty, by and with the advice and
consent of the Senate and House of Commons
of Canada, enacts as follows:

PART I

SHORT TITLE

Short title

1. This Part may be cited as the *Auditor General Act*.

INTERPRETATION

Definitions

2. In this Act,

"Auditor General"

"Auditor General" means the Auditor General of Canada appointed pursuant to subsection 3(1);

"Crown corporation"

"Crown corporation" has the meaning assigned by section 95 of the *Financial Administration Act;* s.c. 1984, c. 31, s. 14

"Department"

"Department" has the meaning assigned to that term by section 2 of the *Financial Administration Act;*

"Registrar"

"Registrar" means the Bank of Canada and a registrar appointed under Part IV of the *Financial Administration Act.*

AUDITOR GENERAL OF CANADA

Appointment and tenure of office

3. (1) The Governor in Council shall, by commission under the Great Seal, appoint a qualified auditor to be the officer called the Auditor General of Canada to hold office during good behaviour for a term of ten years, but the Auditor General may be removed by the Governor in Council on address of the Senate and House of Commons.

Idem

(2) Notwithstanding subsection (1), the Auditor General ceases to hold office on attaining the age of sixty-five years.

Re-appointment

(3) Once having served as the Auditor General, a person is not eligible for re-appointment to that office.

Vacancy (4) In the event of the absence or incapacity of the Auditor General or if the office of Auditor General is vacant, the Governor in Council may appoint a person temporarily to perform the duties of Auditor General.

Salary 4. (1) The Auditor General shall be paid a salary equal to the salary of a puisne judge of the Supreme Court of Canada.

- S.C. 1976-77, c. 34, s. 4(1);
- S.C. 1980-81-82-83, c. 50, s. 23;
- S.C. 1980-81-82-83, c. 55, s. 1.

Pension benefits (2) The provisions of the *Public Service Superannuation Act*, other than those relating to tenure of office, apply to the Auditor General except that a person appointed as Auditor General from outside the Public Service may, by notice in writing given to the President of the Treasury Board not more than sixty days after the date of his appointment as Auditor General, elect to participate in the pension plan provided for in the *Diplomatic Service (Special) Superannuation Act* in which case the provisions of that Act, other than those relating to tenure of office, apply to him and the provisions of the *Public Service Superannuation Act* do not apply to him.

DUTIES

Examination 5. The Auditor General is the auditor of the accounts of Canada, including those relating to the Consolidated Revenue Fund and as such shall make such examinations and inquiries as he considers necessary to enable him to report as required by this Act.

Idem 6. The Auditor General shall examine the several financial statements required by section 55 of the *Financial Administration Act* to be included in the Public Accounts, and any other statement that the President of the Treasury Board or the Minister of Finance may present for audit and shall express his opinion as to whether they present fairly information in accordance with stated accounting policies of the federal government and on a basis consistent with that of the preceding year together with any reservations he may have.

- S.C. 1976-77, c. 34, s. 6;
- S.C. 1980-81-82-83, c. 170, s. 25.

Report to House of Commons 7. (1) The Auditor General shall report annually to the House of Commons

(a) on the work of his office; and,

(b) on whether, in carrying on the work of his office, he received all the information and explanations he required.

Idem (2) Each report of the Auditor General under subsection (1) shall call attention to anything that he considers to be of significance and of a nature that should be brought to the attention of the House of Commons, including any cases in which he has observed that

(a) accounts have not been faithfully and properly maintained or public money has not been fully accounted for or paid, where so required by law, into the Consolidated Revenue Fund;

(b) essential records have not been maintained or the rules and procedures applied have been insufficient to safeguard and control public property, to secure an effective check on the assessment, collection and proper allocation of the revenue and to ensure that expenditures have been made only as authorized;

(c) money has been expended other than for purposes for which it was appropriated by Parliament;

(d) money has been expended without due regard to economy or efficiency; or

(e) satisfactory procedures have not been established to measure and report the effectiveness of programs, where such procedures could appropriately and reasonably be implemented.

Submission of report to Speaker and tabling in the House of Commons

(3) Each annual report by the Auditor General to the House of Commons shall be submitted to the Speaker of the House of Commons on or before the 31st day of December in the year to which the report relates and the Speaker of the House of Commons shall lay each such report before the House of Commons forthwith after receipt thereof by him or, if that House is not then sitting, on the first day next thereafter that the House of Commons is sitting.

Special report

8. (1) The Auditor General may make a special report to the House of Commons on any matter of pressing importance or urgency that, in his opinion, should not be deferred until the presentation of his annual report.

Submission of reports to Speaker and tabling in the House of Commons

(2) Each special report of the Auditor General to the House of Commons made under subsection (1) or 20(2) shall be submitted to the Speaker of the House of Commons and shall be laid before the House of Commons by the Speaker of the House of Commons forthwith after receipt thereof by him, or if that House is not then sitting, on the first day next thereafter that the House of Commons is sitting.

Idem

9. The Auditor General shall

(a) make such examination of the accounts and records of each registrar as he deems necessary, and such other examinations of a registrar's transactions as the Minister of Finance may require, and;

(b) when and to the extent required by the Minister of Finance, participate in the destruction of any redeemed or cancelled securities or unissued reserves of securities authorized to be destroyed under the *Financial Administration Act;*

and he may, by arrangement with a registrar, maintain custody and control, jointly with that registrar, of cancelled and unissued securities.

Improper retention of public money

10. Whenever it appears to the Auditor General that any public money has been improperly retained by any person, he shall forthwith report the circumstances of the case to the President of the Treasury Board.

Inquiry and Report

11. The Auditor General may, if in his opinion such an assignment does not interfere with his primary responsibilities, whenever the Governor in Council so requests, inquire into and report on any matter relating to the financial affairs of Canada or to public property or inquire into and report on any person or organization that has received financial aid from the Government of Canada or in respect of which financial aid from the Government of Canada is sought.

Advisory powers

12. The Auditor General may advise appropriate officers and employees in the public service of Canada of matters discovered in his examinations and, in particular, may draw any such matter to the attention of officers and employees engaged in the conduct of the business of the Treasury Board.

ACCESS TO INFORMATION

Access to information

13. (1) Except as provided by any other Act of Parliament that expressly refers to this subsection, the Auditor General is entitled to free access at all convenient times to information that relates to the fulfilment of his responsibilities and he is also entitled to require and receive from members of the public service of Canada such information, reports and explanations as he deems necessary for that purpose.

Stationing of officers in departments

(2) In order to carry out his duties more effectively, the Auditor General may station in any department any person employed in his office, and the department shall provide the necessary office accommodation for any person so stationed.

Oath of secrecy

(3) The Auditor General shall require every person employed in his office who is to examine the accounts of a department or of a Crown corporation pursuant to this Act to comply with any security requirements applicable to, and to take any oath of secrecy required to be taken by, persons employed in that department or Crown corporation.

Inquiries

(4) The Auditor General may examine any person on oath on any matter pertaining to any account subject to audit by him and for the purposes of any such examination the Auditor General may exercise all the powers of a commissioner under Part I of the *Inquiries Act*.

Reliance on audit reports of Crown corporations

14. (1) Notwithstanding subsections (2) and (3), in order to fulfil his responsibilities as the auditor of the accounts of Canada, the Auditor General may rely on the report of the duly appointed auditor of a Crown corporation or of any subsidiary of a Crown corporation.

Auditor General may request information

(2) The Auditor General may request a Crown corporation to obtain and furnish to him such information and explanations from its present or former directors, officers, employees, agents and auditors or those of any of its subsidiaries as are, in his opinion, necessary to enable him to fulfil his responsibilities as the auditor of the accounts of Canada.

Direction of the Governor in Council

(3) If, in the opinion of the Auditor General, a Crown corporation, in response to a request made under subsection (2), fails to provide any or sufficient information or explanations, he may so advise the Governor in Council, who may thereupon direct the officers of the corporation to furnish the Auditor General with such information and explanations and to give him access to those records, documents, books, accounts and vouchers of the corporation or any of its subsidiaries access to which is, in the opinion of

the Auditor General, necessary for him to fulfil his responsibilities as the auditor of the accounts of Canada.

STAFF OF THE AUDITOR GENERAL

Officers, etc.

15. (1) Such officers and employees as are necessary to enable the Auditor General to perform his duties shall be appointed in accordance with the *Public Service Employment Act*.

Contract for professional services

(2) Subject to any other Act of Parliament or regulations made thereunder, but without the approval of the Treasury Board, the Auditor General may, within the total dollar limitations established for his office in *Appropriation Acts*, contract for professional services.

Delegation to Auditor General

(3) The Auditor General may exercise and perform, in such manner and subject to such terms and conditions as the Public Service Commission directs, the powers, duties and functions of the Public Service Commission under the *Public Service Employment Act*, other than the powers, duties and functions of the Commission in relation to appeals under sections 21 and 31 of that Act and inquiries under section 32 of that Act.

Suspension

(4) The Auditor General may suspend from the performance of his duty any person employed in his office.

Responsibility for personnel management

16. In respect of persons employed in his office, the Auditor General is authorized to exercise the powers and perform the duties and functions of the Treasury Board under the *Financial Administration Act* that relate to personnel management including the determination of terms and conditions of employment and the responsibility for employer and employee relations, within the meaning of paragraph 5(1)(e) and section 7 of that Act.

Collective agreements

17. Any collective agreement affecting persons employed in the office of the Auditor General entered into before the coming into force of this Act remains in force and binds the Auditor General as employer of such persons until the expiry of that agreement.

Classification standards

18. Classification standards may be prepared for persons employed in the office of the Auditor General to conform with the classifications that the Auditor General recognizes for the purposes of that office.

Delegation

19. The Auditor General may designate a senior member of his staff to sign on his behalf any opinion that he is required to give and any report, other than his annual report on the financial statements of Canada made pursuant to section 55 of the *Financial Administration Act* and his reports to the House of Commons under this Act and any member so signing an opinion or report shall indicate beneath his signature his position in the office of the Auditor General and the fact that he is signing on behalf of the Auditor General.

ESTIMATES

Estimates

20. (1) The Auditor General shall annually prepare an estimate of the sums that will be required to be provided by Parliament for the payment of the salaries, allowances and expenses of his office during the next ensuing fiscal year.

Special report

(2) The Auditor General may make a special report to the House of Commons in the event that amounts provided for his office in the estimates submitted to Parliament are, in his opinion, inadequate to enable him to fulfil the responsibilities of his office.

Appropriation allotments

21. The provisions of the *Financial Administration Act* with respect to the division of appropriations into allotments do not apply in respect of appropriations for the office of the Auditor General.

AUDIT OF THE OFFICE OF THE AUDITOR GENERAL

Audit of office of the Auditor General

22. (1) A qualified auditor nominated by the Treasury Board shall examine the receipts and disbursements of the office of the Auditor General and shall report annually the outcome of his examinations to the House of Commons.

Submission of reports and tabling

(2) Each report referred to in subsection (1) shall be submitted to the President of the Treasury Board on or before the 31st day of December in the year to which the report relates and the President of the Treasury Board shall lay each such report before the House of Commons within fifteen days after receipt thereof by him or, if that House is not then sitting, on any of the first fifteen days next thereafter that the House of Commons is sitting.

PART II

CONSEQUENTIAL AND RELATED AMENDMENTS

R.S., c. F-10

23. Part VII of the *Financial Administration Act* is repealed.

R.S., c. P-35

24. (1) Part I of Schedule I to the *Public Service Staff Relations Act* is amended by deleting therefrom the words "Office of the Auditor General of Canada".

(2) Part II of Schedule I to the *Public Service Staff Relations Act* is amended by adding thereto the words "Office of the Auditor General of Canada".

R.S., c. E-8

25. Section 16 of the *Established Programs (Interim Arrangements) Act* is repealed and the following substituted therefor:

Powers of Auditor General

"**16.** Nothing in this Act shall be construed to restrict the powers of the Auditor General of Canada under the *Auditor General Act*."

1970-71-72, c. 52

26. Section 27 of the French version of the *Pilotage Act* is repealed and the following substituted therefor:

Vérificateur général

"27. Le vérificateur général vérifie chaque année la comptabilité et les opérations financières de chaque Administration et en fait rapport au Ministre."

R.S., c. N-22

27. Subsection 23(5) of the *Northwest Territories Act* is repealed and the following substituted therefor:

Powers of Auditor General

"(5) The Auditor General has, in connection with his examination of the accounts of the Territories, all the powers that he has under the *Auditor General Act* in connection with the examination of the accounts of Canada."

R.S., c. Y-2

28. Subsection 26(5) of the *Yukon Act* is repealed and the following substituted therefor:

Powers of Auditor General

"(5) The Auditor General has, in connection with his examination of the accounts of the Territory, all the powers that he has under the *Auditor General Act* in connection with the examination of the accounts of Canada."

1970-71-72, c. 48

29. Section 15 of the French version of the *Unemployment Insurance Act*, 1971 is repealed and the following substituted therefor:

Vérification

"15. Le vérificateur général vérifie chaque année la comptabilité et les opérations financières de la Commission et en fait rapport au Ministre."

Amendments to French version

30. Whenever, in the French version, the expression "auditeur général" appears in any provision of an Act listed in the schedule to this Act, there shall in every case, unless the context otherwise requires, be substituted the expression "vérificateur général".

PART III

COMMENCEMENT

Coming into force

31. This Act shall come into force on a day to be fixed by proclamation.

APPENDIX B

FINANCIAL ADMINISTRATION ACT

EXTRACTS FROM PART XII

FINANCIAL ADMINISTRATION ACT

R.S., c. F-10 (amended)

Extracts from Part XII

CROWN CORPORATIONS

Financial Management

Books and systems

138. (1) Each parent Crown corporation shall cause

(a) books of account and records in relation thereto to be kept, and

(b) financial and management control and information systems and management practices to be maintained, in respect of itself and each of its wholly-owned subsidiaries, if any.

Idem

(2) The books, records, systems and practices referred to in subsection (1) shall be kept and maintained in such manner as will provide reasonable assurance that

(a) the assets of the corporation and each subsidiary are safeguarded and controlled;

(b) the transactions of the corporation and each subsidiary are in accordance with this Part, the regulations, the charter and by-laws of the corporation or subsidiary and any directive given to the corporation; and

(c) the financial, human and physical resources of the corporation and each subsidiary are managed economically and efficiently and the operations of the corporation and each subsidiary are carried out effectively.

Internal audit

(3) Each parent Crown corporation shall cause internal audits to be conducted, in respect of itself and each of its wholly-owned subsidiaries, if any, to assess compliance with subsections (1) and (2), unless the Governor in Council is of the opinion that the cost of such audits is not justified by the benefits to be derived therefrom.

Financial statements

(4) Each parent Crown corporation shall cause financial statements to be prepared annually, in respect of itself and its wholly-owned subsidiaries, if any, in accordance with generally accepted accounting principles as supplemented or augmented by regulations made pursuant to subsection (6).

Form of financial statements

(5) The financial statements of a parent Crown corporation and of a wholly-owned subsidiary shall be prepared in a form that clearly sets out information according to the major businesses or activities of the corporation or subsidiary.

Regulations

(6) The Treasury Board may, for the purposes of subsection (4), make regulations respecting financial statements either generally or in respect of any specified parent Crown corporation or any parent Crown corporation of a specified class, but such regulations shall, in respect of the preparation of financial statements, only supplement or augment generally accepted accounting principles. 1984, c. 31, s. 11.

Auditor's Reports

Annual auditor's report

139. (1) Each parent Crown corporation shall cause an annual auditor's report to be prepared, in respect of itself and its wholly-owned subsidiaries, if any, in accordance with the regulations, on

(a) the financial statements referred to in section 138; and

(b) any quantitative information required to be audited pursuant to subsection (5).

Contents

(2) A report under subsection (1) shall be addressed to the appropriate Minister and shall

(a) include separate statements, whether in the auditor's opinion,

(i) the financial statements are presented fairly in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year,

(ii) the quantitative information is accurate in all material respects and, if applicable, was prepared on a basis consistent with that of the preceding year, and

(iii) the transactions of the corporation and of each subsidiary that have come to his notice in the course of his examination for the report were in accordance with this Part, the regulations, the charter and by-laws of the corporation or subsidiary and any directive given to the corporation; and

(b) call attention to any other matter falling within the scope of his examination for the report that, in his opinion, should be brought to the attention of Parliament.

Regulations

(3) The Treasury Board may make regulations prescribing the form and manner in which the report referred to in subsection (1) is to be prepared.

Separate reports

(4) Notwithstanding any other provision of this Part, the auditor of a parent Crown corporation may prepare separate annual auditor's reports on the statements referred to in paragraph 139(1)*(a)* and on the information referred to in paragraph 139(1)*(b)* if, in his opinion, separate reports would be more appropriate.

Audit of quantitative information

(5) The Treasury Board may require that any quantitative information required to be included in a parent Crown corporation's annual report pursuant to subsection 152(3) be audited.

Other reports

(6) The auditor of a parent Crown corporation shall prepare such other reports respecting the corporation or any wholly-owned subsidiary of the corporation as the Governor in Council may require.

Examination

(7) An auditor shall make such examination as he considers necessary to enable him to prepare a report under subsection (1) or (6).

Reliance on internal audit

(8) An auditor shall, to the extent he considers practicable, rely on any internal audit of the corporation being audited that is conducted pursuant to subsection 138(3). 1984, c. 31, s. 11.

Errors and omissions

140. (1) A director or officer of a Crown corporation shall forthwith notify the auditor and the audit committee of the corporation, if any, of any error or omission of which the director or officer becomes aware in a financial statement that the auditor or a former auditor has reported on or in a report prepared by the auditor or a former auditor pursuant to section 139.

Idem

(2) Where an auditor or former auditor of a Crown corporation is notified or becomes aware of any error or omission in a financial statement that the auditor or former auditor has reported on or in a report prepared by the auditor or former auditor pursuant to section 139, he shall forthwith notify each director of the corporation of the error or omission if he is of the opinion that the error or omission is material.

Correction

(3) Where an auditor or former auditor of a Crown corporation notifies the directors of an error or omission in a financial statement or report pursuant to subsection (2), the corporation shall prepare a revised financial statement or the auditor or former auditor shall issue a correction to the report, as the case may be, and a copy thereof shall be given to the appropriate Minister. 1984, c. 31, s. 11.

Auditors

Appointment of auditor

141. (1) The auditor of a parent Crown corporation shall be appointed annually by the Governor in Council, after the appropriate Minister has consulted the board of directors of the corporation, and may be removed at any time by the Governor in Council, after the appropriate Minister has consulted the board.

Auditor General

(2) On and after January 1, 1989, the Auditor General of Canada shall be appointed by the Governor in Council as the auditor, or a joint auditor, of each parent Crown corporation named in Part I of Schedule C, unless the Auditor General waives the requirement that he be so appointed.

Idem

(3) Subsections (1) and (2) do not apply in respect of any parent Crown corporation the auditor of which is specified by any other Act of Parliament to be the Auditor General of Canada, but the Auditor General is eligible to be appointed the auditor, or a joint auditor, of a parent Crown corporation pursuant to subsection (1) and subsections (8) to (10) do not apply to him.

Exception

(4) Notwithstanding subsection (1), where the report referred to in subsection 139(1) is to be prepared in respect of a wholly-owned subsidiary separately, the board of directors of the parent Crown corporation that wholly owns the subsidiary shall, after consultation with the board of directors of the subsidiary, appoint the auditor of the subsidiary, and subsections (6) and (8) to (11) and section 142 apply in respect of such auditor as though the references therein to a parent Crown corporation were references to the subsidiary.

Criteria for appointment

(5) The Governor in Council may make regulations prescribing the criteria to be applied in selecting an auditor for appointment pursuant to subsection (1) or (4).

Re-appointment

(6) An auditor of a parent Crown corporation is eligible for re-appointment on the expiration of his appointment.

Continuation in office

(7) Notwithstanding subsection (1), if an auditor of a parent Crown corporation is not appointed to take office on the expiration of the appointment of an incumbent auditor, the incumbent auditor continues in office until his successor is appointed.

Persons not eligible

(8) A person is disqualified from being appointed or re-appointed or continuing as an auditor of a parent Crown corporation if he is not independent of the corporation, any of its affiliates, or the directors or officers of the corporation or any of its affiliates.

Independence

(9) For the purpose of this section,

(a) independence is a question of fact; and

(b) a person is deemed not to be independent if he or any of his business partners

(i) is a business partner, director, officer or employee of the parent Crown corporation or any of its affiliates, or a business partner of any director, officer or employee of the corporation or any of its affiliates,

(ii) beneficially owns or controls, directly or indirectly through a trustee, legal representative, agent or other intermediary, a material interest in the shares or debt of the parent Crown corporation or any of its affiliates, or

(iii) has been a receiver, receiver-manager, liquidator or trustee in bankruptcy of the parent Crown corporation or any of its affiliates within two years of his proposed appointment as auditor of the corporation.

Resignation

(10) An auditor of a parent Crown corporation who becomes disqualified under this section shall resign forthwith after becoming aware of his disqualification.

Qualifications preserved

(11) Nothing in this section shall be construed as empowering the appointment, re-appointment or continuation in office as an auditor of a parent Crown corporation of any person who does not meet any qualifications for such appointment, re-appointment or continuation established by any other Act of Parliament. 1984, c. 31, s. 11.

Resignation

142. A resignation of an auditor of a parent Crown corporation becomes effective at the time the corporation receives a written resignation from him or at the time specified in the resignation, whichever is later. 1984, c. 31, s. 11.

Special Examination

Special examination

143. (1) Each parent Crown corporation shall cause a special examination to be carried out, in respect of itself and its wholly-owned subsidiaries, if any, to determine if the systems and practices referred to in paragraph 138(1)*(b)* were, in the period under examination, maintained in a manner that provided reasonable assurance that *(a)* the assets of the corporation and each subsidiary were safeguarded and controlled; and

(b) the financial, human and physical resources of the corporation and each subsidiary were managed economically and efficiently and the operations of the corporation and each subsidiary were carried out effectively.

Time for examination

(2) A special examination shall be carried out at least once every five years and at such additional times as the Governor in Council, the appropriate Minister or the board of directors of the corporation to be examined may require.

Plan

(3) Before an examiner commences a special examination, he shall survey the systems and practices of the corporation to be examined and submit a plan for the examination, including a statement of the criteria to be applied in the examination, to the audit committee of the corporation, or if there is no audit committee, to the board of directors of the corporation.

Resolution of disagreements

(4) Any disagreement between the examiner and the audit committee or board of directors of a corporation over a plan referred to in subsection (3) may be resolved

(a) in the case of a parent Crown corporation, by the appropriate Minister; and

(b) in the case of a wholly-owned subsidiary, by the parent Crown corporation that wholly owns the subsidiary.

Reliance on internal audit

(5) An examiner shall, to the extent he considers practicable, rely on any internal audit of the corporation being examined conducted pursuant to subsection 138(3).

Report

(6) An examiner shall, on completion of the special examination, submit a report on his findings to the board of directors of the corporation examined.

Contents

(7) The report of an examiner under subsection (6) shall include

(a) a statement, whether in the examiner's opinion, with respect to the criteria established pursuant to subsection (3), there is reasonable assurance that there are no significant deficiencies in the systems and practices examined; and

(b) a statement of the extent to which the examiner relied on internal audits.

Special report to appropriate Minister

(8) Where the examiner of a parent Crown corporation named in Part I of Schedule C is of the opinion that his report under subsection (6) contains information that should be brought to the attention of the appropriate Minister, he shall, after consultation with the board of directors of the corporation, report that information to the Minister and furnish a copy of the report to the board.

Idem

(9) Where the examiner of a wholly-owned subsidiary of a parent Crown corporation named in Part I of Schedule C is of the opinion that his report under subsection (6) contains information that should be brought to the attention of the appropriate Minister, he

shall, after consultation with the boards of directors of the subsidiary and corporation, report that information to the Minister and furnish copies of the report to the boards.

Special report to Parliament

(10) Where the examiner of a parent Crown corporation named in Part I of Schedule C is of the opinion that his report under subsection (6) contains information that should be brought to the attention of Parliament, he shall, after consultation with the appropriate Minister and the board of directors of the corporation, prepare a report thereon for inclusion in the next annual report of the corporation and furnish copies of the report to the board, the appropriate Minister and the Auditor General of Canada.

Idem

(11) Where the examiner of a wholly-owned subsidiary of a parent Crown corporation named in Part I of Schedule C is of the opinion that his report under subsection (6) contains information that should be brought to the attention of Parliament, he shall, after consultation with the appropriate Minister and the boards of directors of the subsidiary and corporation, prepare a report thereon for inclusion in the next annual report of the corporation and furnish copies of the report to the boards, the appropriate Minister and the Auditor General of Canada. 1984, c. 31, s. 11.

Examiner

144. (1) Subject to subsections (2) and (3), the auditor of a parent Crown corporation shall carry out a special examination.

Idem

(2) Where, in the opinion of the Governor in Council, a person other than the auditor of a parent Crown corporation should carry out a special examination, he may, after the appropriate Minister has consulted the board of directors of the corporation, appoint an auditor who is qualified for the purpose to carry out the examination in lieu of the auditor of the corporation and may, after the appropriate Minister has consulted the board, remove that qualified auditor at any time.

Exception

(3) Where a special examination is to be carried out in respect of a wholly-owned subsidiary separately, the board of directors of the parent Crown corporation that wholly owns the subsidiary shall, after consultation with the board of directors of the subsidiary, appoint the qualified auditor who is to carry out the special examination.

Applicable provisions

(4) Subject to subsection (5), subsections 141(8) to (10) and section 142 apply in respect of an examiner as though the references therein to an auditor were references to an examiner.

Auditor General eligible

(5) The Auditor General of Canada is eligible to be appointed an examiner and subsections 141(8) to (10) do not apply to him in respect of such an appointment. 1984, c. 31, s. 11.

Consultation with Auditor General

Consultation with Auditor General

145. The auditor or examiner of a Crown corporation may at any time consult the Auditor General of Canada on any matter relating to his audit or special examination and shall consult the Auditor General with respect to any matter that, in the opinion of the auditor or examiner, should be brought to the attention of Parliament pursuant to paragraph 139(2)*(b)* or subsection 143(10) or (11). 1984, c. 31, s. 11.

Right to Information

Right to information

146. (1) On the demand of the auditor or examiner of a Crown corporation, the present or former directors, officers, employees or agents of the corporation shall furnish such

(a) information and explanations, and

(b) access to records, documents, books, accounts and vouchers of the corporation or any of its subsidiaries as the auditor or examiner considers necessary to enable him to prepare any report as required by this Division and that the directors, officers, employees or agents are reasonably able to furnish.

Idem

(2) On the demand of the auditor or examiner of a Crown corporation, the directors of the corporation shall

(a) obtain from the present or former directors, officers, employees or agents of any subsidiary of the corporation such information and explanations as the auditor or examiner considers necessary to enable him to prepare any report as required by this Division and that the present or former directors, officers, employees or agents are reasonably able to furnish; and

(b) furnish the information and explanations so obtained to the auditor or examiner.

Reliance on reports

(3) An auditor or examiner of a Crown corporation may reasonably rely on any report of any other auditor or examiner. 1984, c. 31, s. 11.

Policy

Restriction

147. Nothing in this Part or the regulations shall be construed as authorizing the auditor or examiner of a Crown corporation to express any opinion on the merits of matters of policy, including the merits of

(a) the objects or purposes for which the corporation is incorporated, or the restrictions on the businesses or activities that it may carry on, as set out in its charter;

(b) the objectives of the corporation; and

(c) any business or policy decision of the corporation or of the Government of Canada. 1984, c. 31, s. 11.

Qualified Privilege

Qualified privilege

148. Any oral or written statement or report made under this Part or the regulations by the auditor or a former auditor, or the examiner or a former examiner, of a parent Crown corporation has qualified privilege. 1984, c. 31, s. 11.

Costs

Cost of audit and examinations

149. (1) The amounts paid to an auditor or examiner of a Crown corporation for preparing any report under section 139 or 143 shall be reported to the President of the Treasury Board.

Idem

(2) Where the Auditor General of Canada is the auditor or examiner of a Crown corporation, the costs incurred by him in preparing any report under section 139 or 143 shall be disclosed in the next annual report of the Auditor General and be paid out of the moneys appropriated for his office. 1984, c. 31, s. 11.

Audit Committee

Audit committee

150. (1) Each parent Crown corporation that has four or more directors shall establish an audit committee composed of not less than three directors of the corporation, the majority of whom are not officers or employees of the corporation or any of its affiliates.

Idem

(2) In the case of a parent Crown corporation that has less than four directors, the board of directors of the corporation constitutes the audit committee of the corporation and shall perform the duties and functions assigned to an audit committee by any provision of this Part and the provision shall be construed accordingly.

Duties

(3) The audit committee of a parent Crown corporation shall

(a) review, and advise the board of directors with respect to, the financial statements that are to be included in the annual report of the corporation;

(b) oversee any internal audit of the corporation that is conducted pursuant to subsection 138(3);

(c) review, and advise the board of directors with respect to, the annual auditor's report of the corporation referred to in subsection 139(1);

(d) in the case of a corporation undergoing a special examination, review, and advise the board of directors with respect to, the plan and reports referred to in section 143; and

(e) perform such other functions as are assigned to it by the board of directors or the charter or by-laws of the corporation.

Auditor or examiner's attendance

(4) The auditor and any examiner of a parent Crown corporation are entitled to receive notice of every meeting of the audit committee and, at the expense of the corporation, to attend and be heard thereat; and, if so requested by a member of the audit committee, the auditor or examiner shall attend any or every meeting of the committee held during his term of office.

Calling meeting

(5) The auditor or examiner of a parent Crown corporation or a member of the audit committee may call a meeting of the committee.

Wholly-owned subsidiary

(6) Where the report referred to in subsection 139(1) is to be prepared in respect of a wholly-owned subsidiary separately, subsections (1) to (5) apply, with such modifications as the circumstances require, in respect of the subsidiary as though

(a) the references therein to a parent Crown corporation were references to the subsidiary; and

(b) the reference in paragraph (3)*(a)* to the annual report of the corporation were a reference to the annual report of the parent Crown corporation that wholly owns the subsidiary. 1984, c. 31, s. 11.

Reports

Accounts, etc. to Treasury Board or appropriate Minister

151. (1) A parent Crown corporation shall provide the Treasury Board or the appropriate Minister with such accounts, budgets, returns, statements, documents, records, books, reports or other information as the Board or appropriate Minister may require.

Reports on material developments

(2) The chief executive officer of a parent Crown corporation shall, as soon as reasonably practicable, notify the appropriate Minister, the President of the Treasury Board and any director of the corporation not already aware thereof of any financial or other developments that, in the chief executive officer's opinion, are likely to have a material effect on the performance of the corporation, including its wholly-owned subsidiaries, if any, relative to the corporation's objectives or on the corporation's requirements for funding.

Reports on wholly-owned subsidiaries

(3) Each parent Crown corporation shall forthwith notify the appropriate Minister and the President of the Treasury Board of the name of any corporation that becomes or ceases to be a wholly-owned subsidiary of the corporation. 1984, c. 31, s. 11.

Annual report

152. (1) Each parent Crown corporation shall, as soon as possible, but in any case within three months, after the termination of each financial year submit an annual report on the operations of the corporation in that year concurrently to the appropriate Minister and the President of the Treasury Board, and the appropriate Minister shall cause a copy of the report to be laid before each House of Parliament on any of the first fifteen days on which that House is sitting after he receives it.

Reference to committee

(2) An annual report laid before Parliament pursuant to subsection (1) stands permanently referred to such committee of Parliament as may be designated or established to review matters relating to the business and activities of the corporation submitting the report.

Form and contents

(3) The annual report of a parent Crown corporation shall include

(a) the financial statements of the corporation referred to in section 138;

(b) the annual auditor's report referred to in subsection 139(1);

(c) a statement on the extent to which the corporation has met its objectives for the financial year;

(d) such quantitative information respecting the performance of the corporation, including its wholly-owned subsidiaries, if any, relative to the corporation's objectives as the Treasury Board may require to be included therein; and

(e) such other information as is required by this or any other Act of Parliament, or by the appropriate Minister, the President of the Treasury Board or the Minister of Finance, to be included therein;

and shall be prepared in a form that clearly sets out information according to the major businesses or activities of the corporation and its wholly-owned subsidiaries, if any.

Idem

(4) In addition to any other requirements under this or any other Act of Parliament, the Treasury Board may, by regulation, prescribe the information to be included in annual reports and the form in which such information is to be prepared. 1984, c. 31, s. 11.

Annual consolidated report

153. (1) The President of the Treasury Board shall, not later than December 31 of each year, cause a copy of an annual consolidated report on the businesses and activities of all parent Crown corporations for their financial years ending on or before the previous July 31 to be laid before each House of Parliament.

Reference to committee

(2) An annual consolidated report laid before Parliament pursuant to subsection (1) stands permanently referred to such committee of Parliament as may be designated or established to review matters relating to Crown corporations.

Contents

(3) The annual consolidated report referred to in subsection (1) shall include

(a) a list naming, as of a specified date, all Crown corporations and all corporations of which any shares are held by, on behalf of or in trust for the Crown or any Crown corporation;

(b) employment and financial data, including aggregate borrowings of parent Crown corporations; and

(c) such other information as the President of the Treasury Board may determine. 1984, c. 31, s. 11.

Quarterly report

153.1 (1) The President of the Treasury Board shall cause to be laid before each House of Parliament a copy of a report indicating, in respect of each quarter of each calendar year, the summaries and annual reports that under this Part were to be laid before that House in the quarter, the time at, before or within which they were to be laid and the time they were laid.

Attest

(2) The accuracy of the information contained in each quarterly report shall be attested by the Auditor General of Canada in his annual report to Parliament.

Time for tabling quarterly report

(3) A quarterly report shall be laid before each House of Parliament pursuant to subsection (1) on any of the first thirty days on which that House is sitting after the end of the quarter to which the report relates. 1984, c. 31, s. 11.

APPENDIX C

REPORTS OF THE STANDING COMMITTEE ON PUBLIC ACCOUNTS TO THE HOUSE OF COMMONS

REPORT TO THE HOUSE

Monday, 26 October 1987

The Standing Committee on Public Accounts has the honour to present its

TENTH REPORT

The Public Accounts Committee functions as the audit committee of Parliament. Its concern is sound management of public funds. Through after-the-fact review of audit reports, the Committee encourages public officials to improve the quality of management and of accountability to the taxpayer.

The Committee does not deal with policy matters. It is not the allocation of resources but rather their productive use that is at issue. As members of Parliament, the members of the Committee overview public administration on behalf of Parliament and the Canadian people. The relationship between public servants and the Committee is one of accountability. Where the Auditor General reports audit findings to the House of Commons, it is up to the responsible officials to take appropriate corrective measures. They are answerable to the Committee, meeting in public session, for the timeliness and completeness of these measures.

As the challenge of public sector management increasingly includes not only program delivery and the development of new programs but cost-consciousness and efficiency in existing programs, the adoption of economical, efficient and effective procedures takes on added importance. In this annual report to the House of Commons, the Public Accounts Committee is reviewing many areas of administrative performance. However, the Committee's criticism is tempered with recognition of honest and competent effort on the part of public servants throughout the federal government.

1. In accordance with its permanent Order of Reference contained in the Standing Orders of the House of Commons, your Committee has considered the Report of the Auditor General to the House of Commons and the Public Accounts of Canada for the fiscal year ended March 31, 1986.

2. During the past year, since the start of the Second Session of this Parliament, your Committee has submitted nine reports to the House. This report reviews the major themes of these reports and summarizes their contents. It also outlines the responses received to date to these reports from the Government and from departments and agencies.

3. Since the fall of 1986, the following themes have recurred in the Committee's reports:

A. Cost Savings;
B. Cost-Consciousness of Public Servants;
C. Turnover in Senior Personnel;

D. Interdepartmental Co-ordination,
E. Relationship between Departments and Treasury Board;
F. Safeguarding the Crown against Legal Liability and Financial loss;
G. Disclosure of Financial Information, and
H. Follow-up on Committee Reports

A. COST SAVINGS

Introduction

4. In reports on cash management, the Dome remission order, the Departments of Public Words, Indian Affairs and External Affairs, your Committee's reports have underlined ways of achieving economies in the administration of federal programs.

Savings in Cash Management

5. During the past year, responses to the Committee's report on cash management indicated that substantial savings were being achieved. "Cash management" relates to the billing, collection and deposit of moneys owed to the government, the payment of moneys and the use of government cash balances. (4th Report, 1st Session, 33rd Parliament, May 22, 1985)

6. Your Committee saw the need to have one entity with overall responsibility for the organization of cash management, in the absence of which significant savings had been lost. The Office of the Comptroller General is now the central agency charged with coordinating the activities of the various agencies involved in cash management.

7. With respect to the re-negotiation of banking arrangements, since successfully concluded, your Committee brought the parties together and insisted that they complete their negotiations in a timely manner in view of the potential savings to the public purse in interest payments and costs.

8. As a result of your Committee's report, new procedures and techniques to improve cash management and minimize delays in cash deposits and transfers have been introduced. Improved collection of accounts receivable resulted in a gain of $41 million in 1985-86. Other measures, such as scheduling of payments by due dates and recovery of surplus cash from Crown corporations will save more than $50 million annually.

Less Costly Alternatives to Tax Remissions

9. Your Committee reported on the remission order granted to Hudson's Bay Oil and Gas Ltd., a subsidiary of Dome Petroleum Ltd. (1st Report, 2nd Session, 33rd Parliament, November 4, 1986). Over a ten-year period, Hudson's Bay Oil and Gas was authorized to deduct for income tax purposes the financing costs that Dome incurred in acquiring it. The value of this remission order was estimated to exceed $1 billion. Unlike some form of investment or other available means of financial support, a remission order has no provision for

future reimbursement to the Crown. Since, in this case, a remission order had replaced an offer to purchase debentures, your Committee considered that an opportunity to save public funds had been lost. Your Committee called for a full explanation of the expenditure of large sums of public moneys in any future income tax remission orders. In his response to the Committee, the Minister of Finance undertook to table periodic reports in Parliament on all remission orders, which would include an explanation of their use.

Cost-Effective Management of Government Accommodation

10. Over the past year and for the second time in this Parliament, your Committee reported on the management of the accommodation and services programs of the Department of Public Works particularly the Department's lagging progress in systems development. (2nd Report, 2nd Session, 33rd Parliament, December 18, 1986). Reliable information from an effective financial information system is essential for sound decision-making and efficient cost control and, ultimately, savings for the organization. When your Committee requested information on cost overruns, data were available for only one region of the country. Other information had to be compiled manually.

11. In some cases, the Department's ceiling on delegated authority for contract amendments was exceeded and managers did not know about escalating costs in time to seek required Treasury Board approval. Your Committee called for remedial measures in these areas.

12. In a semi-annual progress report to the Committee, which has been assessed by the Auditor General, the Department has shown progress in areas such as the development of automated project accounting and billing systems. In future progress reports, the Committee will monitor the department's objective of putting in place a financial management system, including a cost accounting system, acceptable to the Office of the Comptroller General, prior to April 1988.

13. Your Committee pointed out unacceptable practices whose elimination would result in considerable savings to the taxpayer. Cost overruns, which may involve retroactive approval of payments to contractors, jeopardize responsible management of public funds. Similarly, contract-splitting bypasses scrutiny by Treasury Board by dividing a contract into smaller amounts below the Department's ceiling for delegated authority. In the case involving non-productive rents, $7 million was paid before the client department was ready to occupy the space.

14. From the point of view of the fairness and economy of the competitive process, you Committee was not satisfied with the Department's extensive use of exemptions from the Treasury Board regulations on mandatory tendering for award of contracts. Over 80 per cent of leasing transactions were not publicly tendered in fiscal year 1985-86. In reply, Treasury Board Secretariat undertook to provide departments and agencies with additional guidelines for the use of such exemptions.

15. Your Committee also sought cost reductions in the provision of architectural and engineering services by Public Works and other departments. With 4,500 professional and support staff in this area, including 1,400 in Public Works, the resources devoted to this sector are larger than similar functions in the private sector. The Committee called upon the Department to demonstrate the continuing need for these significant resources and to avoid duplication in the provision of costly professional services. The Department has responded with a plan to rationalize architectural and engineering services across the public service.

Specifying the Costs of Native Claims Settlements

16. Your Committee found that the Department of Indian Affairs and Northern Development had failed to specify clearly the timing, costs and responsibilities for implementing the federal government's obligations for the James Bay and Northern Quebec native claim settlement (5th Report, 2nd Session, 33rd Parliament, March 16, 1987). In view of the substantial commitment of public funds to native claims settlements, with three settlements reached and other major settlements pending, your Committee called upon the Department to improve its procedures.

Cost Recovery for Trade Services

17. In its report on the comprehensive audit of the Department of External Affairs, your Committee dealt with a number of matters related to cost savings (6th Report, 2nd Session, 33rd Parliament, May 20, 1987). Your Committee noted that the Department provided Canadian business with a wide range of documents, market analyses and data from information systems, but had not decided on partial or full cost recovery for these services. In view of the practice of other countries to recover costs for all such documentation, your Committee called upon the Department to decide on appropriate levels of cost recovery.

18. The Program for Export Market Development (PEMD) provides refundable contribution payments to Canadian exporters. Your Committee noted that a large number of companies were delinquent in reporting to the Department information on increased sales achieved subsequent to the PEMD payment. As this was the basis for cost recovery under the program, your Committee urged the Department to continue its efforts to obtain the needed information and pursue further recoveries.

B. COST-CONSCIOUSNESS

Cost Control in the Department of Public Works

19. Your Committee found that public servants in the Department of Public Works were not sufficiently cost-conscious. Your Committee reported on cases where large sums of public money were wasted on non-productive rents or where cost overruns were allowed to occur (2nd Report of this session). The Committee held the view that public servants needed to be more aware of their responsibilities for the stewardship of public funds, that they must ensure that effective accountability and cost control procedures are in place.

20. The Department informed the Committee of measures to improve cost-consciousness in its own ranks and in client departments, in conjunction with the adoption of the new regime for real property management. Your Committee encouraged the Department to pursue such activities, notably the issue of instructions to staff on compliance with Treasury Board rules and improvements in staff training. At the request of the Committee, the Auditor General assessed the Department's actions in this regard and found, among other things, that the instructions issued to staff regarding compliance with regulations were adequate.

Improved Property Management in the Department of Agriculture

21. The Committee found a lack of cost-consciousness in the Department of Agriculture's management of major capital projects (7th Report, 2nd Session, 33rd Parliament, June 11, 1987). In one case, involving the acquisition of land for a research centre in London, Ontario, substantially more was paid that the appraised value of the land and much more land was acquired than called for in the project definition report. Another case, also in London, Ontario, involved the renewal of the lease for the existing research laboratory. A 10-year renewal at reasonable rates was turned down because of uncertainty over completion of the new laboratory. However, shortly thereafter, a five-year lease was signed at a 600 per cent increase in cost.

22. Your Committee noted that the Department had taken over from Public Works the responsibility for managing its own properties and called upon the Department to demonstrate its capacity to accept these increased responsibilities and be cost-conscious.

C. TURNOVER IN SENIOR PERSONNEL

23. A recurring problem facing your Committee has been the revolving door of senior departmental appointments. The Committee revisits departments, as they are subjected to repeat audits or as the Committee carries out follow-up work. When the Committee is invariably confronted with a new person in charge, accountability becomes difficult to establish or enforce. This issue was commented on in two reports over the last year, on the Departments of External Affairs and Agriculture.

24. Your Committee was concerned that there had been four deputy ministers for international trade over the two year period covered by the comprehensive audit under review (6th Report of this session). The Committee holds the view that such a rapid turnover in senior personnel seriously weakens the accountability process and interferes with sound management. Your Committee asked the Prime Minister to give consideration to the appointment of deputy ministers for a period long enough to be held accountable for their actions.

D. INTERDEPARTMENTAL COORDINATION

Introduction

25. Complex government programs frequently require departments to coordinate their efforts. When such co-operation is not in evidence, the administration of the programs in

question is weakened, and important common objectives may not be attained. Your Committee considered a number of such cases, notably in this reports on the Departments of Public Works, Indian Affairs and External Affairs

Improved Accountability for Property Management

26. At the heart of many of the issues your Committee reported on with respect to the Department of Public Works (2nd Report of this session) was the need to improve communications between the Department and its client departments. With the introduction of the Government's new regime for real property management and the transfer back to line departments of increased responsibilities for the management of their lands and buildings, the relationship with Public Works, as the service agency, remains crucial. Several cases revealed a loose relationship between Public Works and its clients. When examining cost overruns, contract-splitting or the payment of non-productive rents (see paragraph 13 of this report), your Committee time and again saw a need to assign responsibilities in the various departments in order to ensure that client needs were firmly established before expenditures were incurred.

27. In response to the Committee's report, Treasury Board Secretariat made reference to a series of policies which provide direction to departments and agencies on the planning, approval, implementation and control of projects. Although the Secretariat declined to take further action to develop and co-ordinate these guidelines, as requested by the Committee, it referred to the development of project management manuals by the major real property departments (e.g. National Defence, Transport and Parks Canada), which are an extension of the Treasury Board directives in these areas.

Definition of Responsibilities for Native Claims Settlements

28. In your Committee's report on the administration of native claims settlements (5th Report of this session), it was pointed our that the Department of Indian Affairs and Northern Development had failed to specify clearly the responsibilities of the various departments and agencies involved in meeting the federal government's obligations under the James Bay and Northern Quebec Agreement. As other major settlements are pending, your Committee called upon the Department to improve these procedures and report its progress in doing so by March 31, 1988.

A Team Effort to Promote Exports

29. In the 6th Report of this session, your Committee noted the importance of effective coordination between External Affairs and other government departments and agencies in the pursuit of the common objective of promoting Canada's exports. This underlined the need for operational guidelines defining interdepartmental roles and better communication procedures between departments. The Committee noted the need to develop export strategies for specific products, such as pork marketing in Japan, where the trade effort suffered because there was no explicit management plan or framework for action into protect Canada's market share.

30. The Department of External Affairs claimed improvements in its relationship with the Department of Agriculture, including agreed guidelines on the division of responsibilities. However, in view of the evidence it received, the Committee called for a written report on this and other measures to improve the operating relationship with other government departments.

E. RELATIONSHIP BETWEEN DEPARTMENTS AND TREASURY BOARD

Introduction

31. In its reports on the Dome remission order and on the Departments of Public Works, Agriculture and Transport, your Committee commented on the relationship between the Treasury Board, the central agency controlling the public purse strings, and various departments and agencies. Often this relationship lies at the heart of accountability for the expenditure of public funds.

Reporting of Remission Orders

32. The Committee's report on the Dome remission order (1st Report of this session), pointed out the need to report estimated amounts of remission orders in the Public Accounts of Canada, where an exact figure was not available. At present, difficulty in providing a precise figure is used as an excuse for failure to show any figure. The form of the Public Accounts is the joint responsibility of the Minister of Finance and the President of the Treasury Board (pursuant to Section 55(2) of the *Financial Administration Act)*. Replying to your Committee's request for the Treasury Board to develop guidelines for reporting such estimated amounts in the Public Accounts, the Minister of Finance agreed to institute a new form of periodic reporting of remission orders, which would include estimated amounts where practicable. Your Committee considers that improved disclosure in the Public Accounts is also necessary.

Compliance with Treasury Board Rules

33. An important theme of your Committee's report on Public Works (2nd Report of this session) was compliance with Treasury Board rules. Your Committee disapproved, in the strongest possible terms, of situations such as contract-splitting (see paragraphs 13 and 29 above) where the Department knew in advance that Treasury Board approval would be required, but did not seek it. Your Committee considered that reasonable Treasury Board rules should be followed; when directives or guidelines are too rigid or out-of-date, they should be changed.

34. Your Committee noted that changes in the reporting relationship between the Department and Treasury Board, including upward revisions in delegated authority, were being negotiated as part of the new scheme for increased ministerial authority and accountability. Your Committee asked for a progress report on the negotiations and will monitor their outcome.

Controls over Contribution Payments to Indian Bands

35. In its report on the Department of Indian Affairs and Northern Development your Committee dealt with the adequacy of controls over contribution payments to Indian bands (5th Report of this session). The Treasury Board requirement is that these funds be used for the purposes for which they were given. As the Department transferred program delivery responsibilities to Indian bands, it became progressively more difficult to satisfy both the central agency and the Indian bands. This required a balance between accountability to the Minister and Parliament and accountability to Indian bands and their community electorates. Your Committee has requested written progress on these matters by March 31, 1988.

Cost Controls for Capital Projects

36. In an interim report on the radar modernization project (RAMP) of the Department of Transport, your Committee considered the cost control process carried on by Treasury Board Secretariat in regards to major capital projects (9th Report, 2nd Session, 33rd Parliament, June 30, 1987). The latest annual report to the Committee from the Secretariat on this subject was reviewed and, in the course of a public meeting, improvements were suggested in this document. Your Committee also considered the impact of the Secretariat's cost control process on the conduct of the radar modernization project. In view of the Department's questionable use of cost-benefit analysis, which was only completed concurrently with your Committee's meetings of April and May of this year, a further meeting was held on October 20, 1987 which will be the subject of a second report.

F. SAFEGUARDING THE CROWN AGAINST LEGAL LIABILITY AND FINANCIAL LOSS

Introduction

37. In reports on the departments of Insurance, Indian Affairs and Agriculture your Committee considered situations over the past year where problems in the administration of federal programs exposed the Crown to legal liability and/or the risk of significant financial loss.

Supervision of Pension Plans and Financial Institutions

38. Your Committee's 3rd Report called upon the Department of Insurance to ensure that the assets and liabilities of all federally-regulated pension plans are actuarially sound, regularly audited, and that procedures are in place to assess financial solvency. Similarly, your Committee called upon the Department to improve its process for monitoring and assessing financial solvency of financial institutions.

Management of Indian Lands and Moneys

39. When your Committee considered the management of Indian lands and moneys by the Department of Indian Affairs and Northern Development (4th Report of this session), the major concern was that Indian people receive the same standard of care that all Canadians would expect from a professional trustee administering lands, estates and moneys. In view of a 1984 Supreme Court decision which awarded over $11 million in damages to an Indian band

because the Department did not meet its fiduciary obligations, and in view of other pending lawsuits with potential liabilities in excess of $1 billion, the Committee expressed concerns about the significant legal liabilities facing the Crown.

40. Your Committee identified several areas where the Department's standards in its administration of Indian lands, estates and moneys were lacking: inadequate access to the assistance of specialists, including lawyers and surveyors, in processing land transactions; deficiencies in training or experience of personnel handling leases, land surrenders and estates; and inadequate review of the release of funds from Indian bands' trust accounts.

41. In its report, your Committee took note of three areas of action to improve the handling of Indian assets: (i) proposed amendments to the *Indian Act*, (ii) a comprehensive study of the problem by the Office of the Comptroller General, and (iii) interim action pending completion of this study and/or introduction of amendments to the law. In view of the urgent need to improve service to Indian people and protect the Crown against the major liabilities involved, your Committee insisted on detailed progress reports from the Department and, upon receipt of the first set of these responses, held a follow-up meeting with the Department and the Office of the Comptroller General. In this meeting, Departmental officials explained their objective of 100 per cent accuracy and competent management of Indian trust assets and committed themselves to further progress. In addition, the Committee received and explanation from the Office of the Comptroller General on the scope, nature and timing of its comprehensive study.

Administration of Agricultural Stabilization and Crop Insurance Programs

42. In your Committee's report on the Department of Agriculture (7th Report of this session), an important issue was the need to improve the administration of the Western Grain Stabilization and Crop Insurance programs, in view of their respective deficits. With reference to the Western Grain Stabilization fund, the Committee called upon the Department to protect against future losses by improving the analysis of information on trends and external influences. In the case of Crop Insurance, the Committee noted that the Department needed to ensure that adequate reserves were maintained to meet unforeseen losses and that risks were fully assessed by recognizing long-term expected claims experience. The Committee requested a detailed progress report in these areas.

G. DISCLOSURE OF FINANCIAL INFORMATION

Introduction

43. Timely disclosure of financial information is an important part of the accountability process. Your Committee has had occasion to comment on the adequacy of financial disclosure in its reports over the last year on the Dome remission order, the Department of Indian Affairs and Northern Development and the Government's financial statements.

Disclosure of Remission Orders

44. Under directives made pursuant to the *Financial Administration Act*, the amounts of remission orders are to be reported in the Public Accounts of Canada. The fact that such an amount was not reported for the Dome remission order was raised in your Committee's 1st Report of this session. The Committee reviewed the reasons why the Department of Finance did not attempt to calculate an amount for this remission order; however, the Committee considered that some figure, even if an estimate, should be provided to indicate the extent of the commitment of public funds. The Treasury Board was asked to develop guidelines for the reporting in the Public Accounts of the estimated amounts of remission orders where an exact figure was not available. In reply, the Minister of Finance has undertaken to provide Parliament with a periodic report on remission orders, which would include such estimates where practicable (see also paragraph 32 above).

45. Another matter arising from the Dome report was the issue of disclosure of financial information to the Auditor General. Officials of the Department of Finance withheld from the Auditor General's staff an economic analysis of the Dome remission order prepared for Cabinet. The Auditor General was thereby denied access to pertinent information and his audit was impeded. The Committee was greatly concerned by this interference with the work of the Auditor General. As Parliament's auditor, the Auditor General is entitled to reasonable access to non-political information, in particular to economic studies.

Reporting the Costs of Native Claims Settlements

46. When reporting on the administration of native claims settlements in its 5th Report of this session, your Committee noted that the liabilities represented by these settlements were not included in the Statement of Assets and Liabilities in the government's financial statements. Because the government was unable to determine the amounts ultimately payable, there had been no attempt to estimate these liabilities and present them in the annual financial statements in the Public Accounts. Your Committee called upon the Government to estimate these liabilities where claims settlements have been reached and include a provision for them in its Statement of Assets and Liabilities. In its response to the Committee, the Government held that the appropriate reporting treatment for such amounts was disclosure as contingent liabilities and not as liabilities on the Statement of Assets and Liabilities.

Financial Reporting to Parliament

47. In its report on the 1985-86 Public Accounts, Vol. I, the Government's financial statements and the Auditor General's opinion and observations on these statements, the Committee dealt with the need for improved financial reporting to Parliament (8th Report, 2nd Session, 33rd Parliament, June 30, 1987). The Committee supported and encouraged the work done in this area by the Offices of the Auditor General and the Comptroller General and the Canadian Institute of Chartered Accountant's Public Sector Accounting and Auditing Committee (PSAAC). The significant findings of the Auditor General's Federal Government Reporting Study were noted; the Committee endorsed the need for an annual financial report for parliamentarians and other users of Government financial information and requested a progress report from the government by September 30, 1987 with respect to the Study's recommendations.

48. Your Committee also emphasized in its 8th Report the need for certain changes in the Government's stated accounting policies in order that a "clean" opinion with no reservations could be made by the Auditor General on the Government's annual summary financial statements. The accounting policies which are in dispute by the Auditor General, raise issues that have an impact on the published size of the Government's deficit, e.g. the government reporting entity, the recording of liabilities, and the provision for borrowings of Crown corporations.

49. The Committee also considered the issue of disclosure of financial information in various areas of the government's summary financial statements. Improvements have been introduced in the reporting of Crown corporation financial information in the 1986 Public Accounts. Further improvements are planned for the 1987 Public Accounts and your Committee has requested a progress report from the Government by September 30, 1988 on the overall issue of the consolidation of Crown corporations in the government's financial statements.

H. FOLLOW-UP ON COMMITTEE REPORTS

Introduction

50. The follow-up process is an integral part of the relationship between the Committee and government departments and agencies. As the audit committee of Parliament, the Committee is concerned with the nature and extent of the remedial actions in response to its recommendations. The process may involve the submission of progress reports, assessments of these by the Auditor General and, if necessary, follow-up meetings. Illustrations of the Committee's follow-up work were offered in reports over the past year on the Departments of Public Works, Insurance, Indian Affairs, External Affairs and Agriculture.

Progress Reports from the Department of Public Works

51. The Committee's 2nd Report of this session was both a follow-up on an earlier report on the Department of Public Works (2nd Report, 1st Session of this Parliament, April 1, 1985) and a consideration of new audit observations related to the Department. The Committee identified unresolved areas of concern from the 1985 report and several new areas where remedial action was sought. In all cases, the Committee called for progress reports from the Department and assessments of these reports by the Auditor General.

Monitoring the Regulation of Financial Institutions and Pension Plans

52. One of the Committee's concerns in its report on the Department of Insurance (3rd Report of this session) was the need to ensure improvements in outdated methods and technology for the regulation of financial institutions and pension plans. Accordingly, the Committee called upon the Auditor General to monitor the Department's progress in updating its methodology and upgrading its work tools and include this monitoring function as part of his regular follow-up work.

Progress Reports from the Department of Indian Affairs and Northern Development

53. In two reports over the past year on the Department of Indian Affairs and Northern Development (4th and 5th Reports of this session), your Committee followed up on matters arising from earlier reports and called for a series of progress reports from the Department.

54. The matters from earlier reports (1st Report of the 1st Session of this Parliament, February 11, 1985 and 6th Report of the 1st Session of the 32nd Parliament, June 23, 1981) related to better controls over contribution payments to Indian bands, an amendment to the Indian Act to improve controls over the payment of monies from bands' trust accounts, and clarification of the mandate of the department. In all cases, further responses were requested from the Department.

55. With respect to ongoing progress reports, the Committee called for a semi-annual update from the Department on a series of undertakings in evidence to improve the management of Indian lands, estates and moneys. The Auditor General has been requested to assess each of these reports on behalf of the Committee and a follow-up meeting has taken place to review the first round of these responses.

Updates from the Departments of External Affairs and Agriculture

56. In its reports on the Departments of External Affairs and Agriculture (6th and 7th Reports of this session) the Committee continued the practice of requesting progress reports and assessment of these reports by the Auditor General. In addition, reference was made in both reports to previous reports or activities of the Committee.

57. Your Committee considered the Main Estimates of the Office of the Auditor General for the fiscal year ending March 31, 1988. This was an historic occasion, the first time the Standing Committee on Public Accounts has considered the Auditor General's estimates, which traditionally have been referred to another Committee. Among the issues discussed by the Committee was the need for an amendment to the *Auditor General Act*, to allow periodic as well as annual reports to the House. This would enable the Committee to scrutinize the Auditor General's audit findings and make observations and recommendations soon after the audit is completed.

58. A copy of the relevant Minutes of Proceedings and Evidence *(Issue No. 26 which includes this report)* is tabled.

Respectfully submitted,

AIDEEN NICHOLSON
Chairman

REPORT TO THE HOUSE

Monday, 2 November 1987

The Standing Committee on Public Accounts has the honour to present its

ELEVENTH REPORT

1. In accordance with its permanent Order of Reference contained in the Standing Orders of the House of Commons your Committee has considered the Report of the Auditor General to the House of Commons for the fiscal year ended March 31, 1986 and, in particular, Chapter 4, Income Tax Expenditures.

2. The co-operation of the witnesses who appeared before your Committee is acknowledged and appreciated.

3. Your Committee noted that tax expenditures form a significant part of federal government spending. The level of tax expenditures is comparable to the annual budgetary deficit. Based on 1982 and 1983 data, for example, the Auditor General estimated total annual tax expenditures at $28 billion, while the budgetary deficit for the fiscal year ended March 31, 1983 totalled $24.7 billion. Much of this expenditure, estimated at $19 billion, involved changing the bahavior of individual and corporate taxpayers to achieve public policy objectives. The other $9 billion of tax expenditures was directed at taxpayers' special circumstances, such as the income tax deduction, based on age, allowed to senior citizens.

4. Because tax expenditures induce changes in taxpayer behavior and because it is generally not possible to know in advance how taxpayers will react, it is difficult to measure the costs of tax expenditure programs. Given the 18-month delay in obtaining information from tax returns and the tendency for taxpayers to develop avoidance mechanisms, tax expenditures are high-risk programs that may expose the treasury to far greater costs than initially anticipated.

Previous Reports

5. Your Committee has previously reported on a major tax expenditure program, the Scientific Research Tax Credit (SRTC) (14th Report, 1st Session, 33rd Parliament, June 26, 1986). In that report, your Committee made general recommendations with respect to improved procedures required for sound management of all tax expenditures. In particular, your Committee recommended that:

(a) pre-funding be avoided in tax expenditure programs;

(b) Parliament be informed about the results of any consultation process preceding the introduction of tax expenditures;

(c) Parliament be informed of any changes in the interpretation of tax expenditure legislation;

(d) the Department of Finance take urgent action to ensure that adequate controls are in place to safeguard public funds;

(e) Parliament receive an annual report on the objectives and costs of major tax expenditure programs;

(f) a mechanism be developed to alter quickly a tax expenditure program where significant problems have been encountered; and

(g) the Department of Finance implement comprehensive program evaluations for all tax expenditures, in accordance with the standards set by the Office of the Comptroller General.

6. Your Committee also reported on a remission order granted to a subsidiary of Dome Petroleum Ltd. (1st Report, 2nd Session, 33rd Parliament, November 4, 1986). Although the *Financial Administration Act*_ requires disclosure of the costs of remission orders in the Public Accounts of Canada, the Department of Finance has not been publishing amounts in some cases on the grounds that it is difficult to arrive at accurate figures. Your Committee considers an estimate is better than nothing and therefore recommended that estimated cost be published and identified as such in cases where the Department of Finance is unable to give firm costs.

7. The Department informed your Committee that a process would be in place by March 31, 1988 to report on income tax remission orders. Such reports, to be tabled by the Minister of Finance, will include cost estimates where applicable.

8. Your Committee has considered the major issues arising from the Auditor General's chapter on income tax expenditures. These issues reinforced your Committee's concerns in the SRTC and Dome reports:

(a) provision of accurate and timely information to Parliament on all major tax expenditure programs;

(b) establishment of an effective program evaluation function;

(c) monitoring of tax expenditures to ensure that excessive tax avoidance is curtailed by timely legislative change; and

(d) other issues, such as double benefits to Crown Corporations through the tax system and the impact of the current tax reform process on tax expenditures.

Information for Parliament

9. The Auditor General informed your Committee that the Department of Finance had failed to provide Parliament with appropriate tax expenditure information. In order to reach this conclusion, the Auditor General examined the full range of information provided to Parliament for several major tax expenditure programs. He examined the following

documentation: the Fiscal Plan, the Estimates, the Public Accounts, Budget Papers, explanatory notes to Bills amending the *Income Tax Act*, and tax expenditure accounts.

10. Your Committee considers that improvements are required both in the quality of tax expenditure information and in the process whereby such information is provided to Parliament.

11. The Department of Finance noted that the proposals for tax reform, tabled by the Minister of Finance in June of this year, will alter of terminate a number of major tax expenditure programs. The Department pointed out that tax reform has been accompanied by widespread consultation with the public and with Parliament. Your Committee is encouraged by the Department's progress in this regard. It is to be hoped that all future tax expenditure measures are subjected to an equally open process, with ample opportunity for Parliamentary review.

12. In particular, as was recommended in the SRTC Report, your Committee seeks an annual report, to be tabled by the Minister of Finance, stating the objectives of every major tax expenditure program, the estimated costs of these programs and information on the progress towards these objectives.

13. The Minister of Finance has indicated, in his written response to the SRTC report, that consideration is being given to the regular publication of a tax expenditure account. Your Committee noted that such accounts were published in 1979, 1980 and 1985 and that the Auditor General has criticized these accounts because the benefits of tax expenditures were not identified and because the information in them was up to three years out-of-date.

14. Officials from the Department of Finance stated that the next account of tax expenditures might appear after Parliament has finished consideration of the tax reform proposals. Concerns were raised about the inaccuracy of past estimates of the costs of tax expenditures, given the reliance on tax returns for accurate data. It was also stated that the completion of program evaluations would render such estimates more accurate.

15. In view of the fact that three tax expenditure accounts have already appeared and in view of the need for such information by Parliament and the public, your Committee is not satisfied with the Department's progress in this regard.

Recommendation

16. Your Committee recommends that the Department of Finance prepare a tax expenditures account for 1987, that the Minister table said account in Parliament, and that such accounts be tabled annually thereafter.

17. With respect to future program evaluation reports on tax expenditures, the Department stated its intention, subject to the approval of the Minister, to make these public,

unless their contents interfered with budget secrecy. Your Committee recommended in 1980 that all effectiveness evaluations be tabled in Parliament because they provide essential information to Parliamentarians on the performance of programs in achieving the objectives set out in legislation (1st Report, 1st Session, 32nd Parliament, July 18, 1980). In 1983, the government responded to your Committee with a decision to publish summaries of relevant program evaluations in Part III of the Estimates. However, no such information has been published by the Department of Finance.

Recommendation

18. Your Committee recommends that the Minister of Finance table all program evaluations undertaken by his Department. Those directly related to a budget should be tabled as part of the Budget Papers.

Program Evaluation

19. In the case of the tax expenditure programs studied by the Auditor General, there was no evidence of a systematic process to review the alternative modes of delivering the programs, nor was there evidence of value-for-money considerations in the decision to go ahead with the programs.

20. Your Committee has raised the following general questions with respect to the process whereby tax expenditure programs are approved and managed:

(a) What sort of analysis was done in the Department of Finance originally for every major program?

(b) What were the objectives of these programs? Have these objectives been met?

(c) What analysis was done of the potential and/or actual revenue loss?

(d) Who would take (has taken) advantage of the program? and

(e) Were benefit-cost studies done, comparing alternatives to the program such as grants or contribution programs?

21. Many of these basic questions may be addressed by a program evaluation function. Your Committee was therefore pleased by the Department's initiative in establishing a program evaluation division, independent of line management. This division is presently being staffed and its mandate includes the evaluation of tax expenditure programs.

22. Your Committee is concerned that some of the resources of the evaluation division be devoted to tax expenditures with higher risks of avoidance activity. Your Committee also wishes to be kept informed of the progress of the evaluation unit.

Recommendation

23. Your Committee recommends that the Department of Finance:

(a) **give consideration to the program evaluation of higher risk tax expenditures on a priority basis;**

(b) **provide your Committee with a written response to recommendation (a) and a progress report by March 31, 1988 on the work plan and activities of the evaluation division;**

(c) **simultaneously provide the Auditor General with a copy of the report requested in recommendation (b) and that the Auditor General assess it on behalf of your Committee and include his findings in the follow-up on his chapter.**

Monitoring

24. One of the key concerns of your Committee's SRTC Report was the need to develop a mechanism to alter quickly a tax expenditure program where significant problems have been encountered. The ability to do this depends on the system in place to monitor tax expenditure programs.

25. The Department of Finance drew a distinction between the evaluation of tax expenditure programs and the procedures in place to monitor them. Monitoring at present depends on a close working relationship with the Department of National Revenue-Taxation and with the community of tax professionals. While your Committee has reservations about the objectivity of those who stand to gain from tax avoidance, the productive and expeditious use of information from Revenue Canada is essential to the monitoring process. In this regard, your Committee noted the comments of the Auditor General, that there have been improvements in monitoring procedures carried our jointly by the Departments of National Revenue-Taxation and Finance.

Recommendation

26. Your Committee recommends that the Department of Finance:

(a) **provide your Committee with a written progress report by March 31, 1988 on improvements in the monitoring of tax expenditure programs; and**

(b) **simultaneously provide the Auditor General with a copy of the aforementioned report and that the Auditor General assess it and include his findings in his follow-up report.**

Use of Tax Expenditures by Crown Corporations

27. Your Committee noted a disagreement between the Department of Finance and the Auditor General about the use of tax expenditures by Crown corporations that are subject

to income tax. While the Department sought to protect the competitive position of commercially-oriented Crown corporations by not denying them tax breaks available to their competitors, the Auditor General was concerned about such Crown corporations bypassing Parliamentary processes and obtaining additional funds through the tax system.

28. Where a Crown corporation is dependent on public funding, your Committee is concerned that a full accounting be given of the use of these funds, including tax expenditures.

Recommendation

29. Your Committee recommends that:

(a) **Crown corporations dependent on public funds provide an accounting for the use of any tax expenditure in their annual report;**

(b) **the Minister of Finance issue directions to all parent Crown corporations to this effect; and**

(c) **the Minister of Finance and the President of the Treasury Board ensure that this information is included in Volume III of the Public Accounts.**

30. With respect to the package of tax reform proposals tabled by the Minister of Finance in June 1987, your Committee noted that the Standing Committee on Finance, Trade and Economic Affairs is studying this matter. Your Committee therefore defers further comment on the effects of tax reform on tax expenditures.

31. Your Committee requests a Government response to recommendations 16, 18, and 29 above in accordance with S.O. 99(2).

32. A copy of the relevant Minutes of Proceeding and Evidence *(Issues Nos. 23, 24, and 26 which includes this report)* is tabled.

Respectfully submitted,

AIDEEN NICHOLSON
Chairman

REPORT TO THE HOUSE

Wednesday, 4 May 1988

The Standing Committee on Public Accounts has the honour to present its

TWELFTH REPORT

1. In accordance with its mandate under Standing Offer 96(3)(f) and an Instruction received from the House of Commons on Tuesday, September 15, 1987, your Committee visited, in November 1987, The Hague in the Netherlands, Frankfurt and Bonn in the Federal Republic of Germany, and Stockholm in Sweden, and met with its parliamentary counterparts and the auditors general of each of these countries.

2. Your Committee has already commented on the practices and procedures observed in the United States and the United Kingdom in a Report to the House on Wednesday, May 28, 1986 (Twelfth Report, 1st Session, 33rd Parliament). Since several of these practices and procedures were applicable to the Canadian parliamentary committee system, your Committee recommended to the House a number of changes to enhance its own effectiveness and to strengthen the overall accountability process.

3. One recommendation was that the Auditor General reported periodically to the House on his comprehensive audits on a completion-date basis. This has been requested by the Auditor General on several occasions; was dealt with by this Committee in another report (Fifth Report, 2nd Session, 32nd Parliament); and has been the subject of three private member's bills. It is evident that members of your Committee and other parliamentarians recognize the value of periodic reporting. Another suggested change was the need for an annual debate in the House on your Committee's reports so as to expedite greater follow-up action to its recommendations. **To date, neither of these changes has been implemented.** Your Committee will continue to press for these changes having now seen their usefulness and benefits in the parliaments of the United Kingdom, the Netherlands, the Federal Republic of Germany, and Sweden.

4. In this report, your Committee wishes to re-emphasize the importance of strengthening the accountability of Government to Parliament and the role your Committee plays as the audit committee of Parliament which is concerned with the sound management and control of public funds. The purpose of this report, therefore, is to indicate to the House a number of initiatives which the Public Accounts Committee wishes to pursue as a result of its European visit. These initiatives fall under the following headings:

(a) improving parliamentary control of the budgetary process; and
(b) increasing productivity and efficiency in Government.

A. Improving Parliamentary Control of the Budgetary Process

5. During its visit to Bonn and The Hague, your Committee observed the linkage between the audit and budget committees. Members of the audit committee are also members of the budget committee and bring to the latter their unique perspective on the performance of government departments and agencies based on audited results. In some cases, budget cuts were proposed unless corrective action was taken by the department or agency; in other situations, cost savings or levels of efficiency were criteria for determining ministry budget levels.

6. Your Committee also noted how the Dutch audit committee, the Committee on Public Spending, with its specialized knowledge of financial controls and other useful audit information, assisted other parliamentarians in the preparation for the budget examinations of each ministry, thereby improving the parliamentary scrutiny of estimates.

7. The lack of parliamentary control over expenditure has been a concern of the Public Accounts Committee since the mid-seventies when a former Auditor General reported that Parliament was close to losing control of the public purse. Since then, government deficits and public spending have increased annually. In the meantime, numerous independent studies, royal commissions, and special committees of the House have examined the expenditure review process, but no major reforms have yet taken place to provide the House of Commons and its committees with the degree of influence on the Government's budget and expenditure plan that was seen in Washington, Bonn, Stockholm and The Hague.

8. Your Committee recognizes the major difference between the parliamentary system in Canada and that in the United States and in Europe. However, with the new powers given to the standing committees in recent years, your Committee believes that new parliamentary procedures must be established to improve Parliament's influence and control of the public purse.

9. Your Committee notes that members of standing committees have developed considerable knowledge of departmental policies and programs. These committees tend to focus attention on policy matters rather than to a line-by-line study of the Estimates. While the Public Accounts Committee reviews audit findings after the fact, there remains a gap in the review of government expenditures. Better scrutiny of public spending is needed before such expenditures are made.

Recommendation

10. Your Committee recommends that:

(a) **the House establish a budget committee to consider the Estimates, and that this committee be composed of members of the Public Accounts Committee and members of the appropriate standing committees; and**

(b) **the Government not consider a reduction in the Estimates as a matter of non-confidence.**

B. Increasing Productivity and Efficiency

11. During its European visit, your Committee observed that work measurement systems were used extensively in government departments and agencies in each of the three countries. In particular, Members noted with interest that, in the Federal Republic of Germany, the President of the Court of Audit, i.e. the Auditor General, was also the Commissioner for Efficiency and could, in this capacity, report to Parliament on matters relating to efficiency and productivity in the public service.

Recommendation

12. Your Committee recommends that the Government consider giving additional powers to the Comptroller General to require departments and agencies to improve productivity and efficiency.

13. Your Committee requests that the Government table a comprehensive response to the recommendations contained in this Report in accordance with Standing Order 99(2).

14. A copy of the relevant Minutes of Proceedings and Evidence *(Issue No. 39 which includes this Report)* is tabled.

Respectfully submitted,

AIDEEN NICHOLSON
Chairman

REPORT TO THE HOUSE

Wednesday, 29 June 1988

The Standing Committee on Public Accounts has the honour to present its

THIRTEENTH REPORT

1. In accordance with its mandate under Standing Order 96(3)(f) your Committee has considered the Report of the Auditor General to the House of Commons for the fiscal year ended March 31, 1987 and, in particular, chapters 4, 5, 7, 11, 12, 13 and 14, relating to the Financial Management and Control Study.

2. The cooperation of the witnesses who appeared before your Committee is acknowledged and appreciated.

3. The Financial Management and Control Study (FMCS) examined and assessed the adequacy of financial management and control practices across government. Your Committee noted the Auditor General's overall finding that significant improvements have been made in financial controls since the first FMCS study in 1975-76. Financial controls relate to proper recording, protecting and accounting for assets owned by the government and to ensuring that funds are spent only for the purposes stated and within the limits approved by Parliament. The Auditor General found that there are now systems and procedures that provide basic financial controls.

4. Your Committee therefore turned its attention to financial management, where government performance was much less salutary. The Auditor General informed your Committee that financial management is far from satisfactory, both on a government-wide basis and within individual departments.

5. Your Committee noted the Auditor General's use of a broad definition of financial management to mean that decision-makers such as Parliament, ministers and departmental managers should know the financial implications of their decisions. Operations should be carried out with due regard to economy, efficiency and effectiveness and information should be available to hold managers accountable for their use of resources. Your Committee endorses this definition of financial management and urges its adoption by departments and agencies.

6. Your Committee considered the major themes within the Financial Management and Control Study and, based on the evidence received from the six departments that appeared before it, your Committee has selected the following matters for further commentary:

(a) financial accountability;
(b) systems development;
(c) the role of the financial function; and
(d) efficiency, productivity and cost savings.

A. Financial Accountability

7. Managers must account for the resources entrusted to them. Financial accountability therefore entails providing information on what activities were carried out showing that the activities were carried out with the greatest possible degree of efficiency, prudence and probity, and giving information about the extent to which the activities achieved what was expected of them.

8. Your Committee considered the three levels of financial accountability in departments and agencies - accountability to departmental managers, to Treasury Board and Parliament. In particular, your Committee focused on several aspects of financial management related to financial accountability;

(i) the Increased Ministerial Authority and Accountability agreements between departments and the Treasury Board;

(ii) the adequacy of cost information; and

(iii) information for Parliament.

9. Increased Ministerial Authority and Accountability (IMAA) refers to a process whereby the division of responsibilities between Treasury Board and departments is to be renegotiated. It responded to a perception of excessive requirements for departments to make submissions to Treasury Board. Based on a Memorandum of Understanding signed by the Minister, the Deputy Minister, the President of the Treasury Board and the Secretary of the Treasury Board, the financial and administrative authority given to a department is specified, usually within broader limits than previously. Agreements are tailored to individual departments with greater delegation of authorities and flexibility in administration. In return for increased powers, departments are subject to expanded annual reporting requirements.

10. Your Committee's concern is that IMAA function well and become a comprehensive and systematic instrument of financial accountability between departments and the Treasury Board. However, in this process, increased delegation of responsibilities to departments should not become an abdication of Treasury Board's functions as a central agency charged with the management of public funds. In addition, the Auditor General has pointed out that IMAA may be founded on quicksand, because some of the mechanisms on which it relies do not work well.

11. One of the key mechanisms on which IMAA is based is the Operational Plan Framework, which is intended to identify specific linkages between resources consumed and results achieved. In the Departments of National Health and Welfare and Energy, Mines and Resources, your Committee noted that the Operational Plan Frameworks did not adequately link resources to results nor specify intended results. The Auditor General has concluded that Operational Plan Frameworks are not yet useful tools for resource allocation and do not provide an adequate basis for accountability.

Recommendation

12. Your Committee recommends that departments and Treasury Board ensure, prior to the implementation of an IMAA agreement, that objectives and results for each program are clearly identified and that resources consumed are lined to results achieved.

13. Your Committee noted that the IMAA process was started in February 1986. However, to date only two Memoranda of Understanding have been signed, with the Departments of National Revenue (Customs and Excise) and Labour. Some departments are not yet ready to start an IMAA discussion with Treasury Board. The Department of Energy, Mines and Resources, for example, has recently experienced major structural changes and informed your Committee that it did not seek to be in the first group of IMAA departments.

Recommendation

14. Your Committee recommends that the Treasury Board and departments and agencies continue the IMAA process.

15. An area related to financial accountability and the IMAA process is the need for better cost information across government. The Auditor General informed your Committee that there is an enormous lack of cost information in departments and agencies and that such information is absolutely essential to sound financial management and to the development of a memorandum of understanding under the IMAA scheme.

16. The Department of Transport provided a striking example of a lack of cost information. Although the Department operates in a quasi-commercial environment for which cost information is particularly needed, the Auditor General found that information for cost control, rate setting and performance measurement was often not available. As the Auditor General stated the matter in relation to airport costs: the Department does not know its costs and does not have systems in place to know its costs.

17. Your Committee also noted problems with respect to cost information and cost accounting systems in the Departments of Supply and Services and National Health and Welfare. For example, the Department of National Health and Welfare did not know the total costs for the Old Age Security Program for fiscal year 1986-87 because of a change in cost reporting methods.

18. The Office of the Comptroller General has recognized the government-wide deficiencies with respect to cost information and has undertaken the development of methodology and standards in this area.

Recommendation

19. Your Committee recommends that the Office of the Comptroller General report its progress by March 31, 1989 with respect to improvements in cost information in departments.

20. An essential component of financial accountability is the provision of accurate, timely and comprehensive information to Parliament, so that Parliament may discharge its responsibilities for the stewardship of public funds. One important source of financial information for Parliament is Part III of the Estimates. Your Committee participated in the establishment of the Part IIIs (Twelfth Report, 1st Session, 32nd Parliament) and has encouraged their development as sources of sound information for Parliamentarians.

21. In view of your Committee's continuing involvement with Part III of the Estimates, the Auditor General's finding of major weaknesses in financial accountability information contained in part IIIs is a matter of concern. In particular, your Committee noted that several of the departments that appeared before it did not provide important information on spending or on the financial implications of certain initiatives in their respective Part IIIs.

22. For example, the Department of Supply and Services did not provide adequate information in its Part III to give a clear picture of the nature and costs of the products or services it provided. The Department of National Health and Welfare provided little progress reporting on new initiatives in its Part III and there was inadequate disclosure of program costs. Lastly, the Department of Energy, Mines and Resources failed to provide precise information in its Part III on the quantifiable aims, objectives and results of each of its programs.

23. In view of the responsibility of the Office of the Comptroller General for the form and content of the Estimates, your Committee considers that this central agency should co-ordinate improvements in the part IIIs.

Recommendation

24. Your Committee recommends that the Office of the Comptroller General co-ordinate improvements in Part III of the 1989-90 Estimates of departments and agencies to respond to the weaknesses identified in the Auditor General's Financial Management and Control Study.

B. Systems Development

25. With respect to financial management information systems, your Committee noted that accurate and reliable information, available at appropriate times, is essential for good financial management and control. Approximately $300 million is spent each year in government departments and agencies on financial computer systems.

26. In view of the importance of financial systems for good financial management and the significant amount spent on them each year, your Committee is concerned by the Auditor General's findings of a pattern of project failures, cost overruns, poor operating performance, duplication of effort and significant waste. In evidence before your Committee, the Secretary of the Treasury Board referred to financial systems management as a "disaster".

27. In particular, your Committee noted serious financial systems problems in a number of departments that appeared before it. In the Department of Supply and Services, for example, systems development projects have not always met objectives nor been completed on time. Inconsistent performance in systems development has contributed to higher product costs.

28. In the Department of Transport, serious and persistent difficulties have been experienced in the development of financial information systems. Your Committee noted several cases of cost overruns and missed completion deadlines. Similarly, in the Department of National Revenue (Customs and Excise), computer systems were not developed with due regard for economy and efficiency and have been poorly managed.

29. Inadequacies in departments' financial systems may be linked to unsatisfactory monitoring and control by the Treasury Board Secretariat. The Auditor General informed your Committee that the present monitoring and control process for the development of financial information systems does not work.

30. The Office of the Comptroller General informed your Committee that it is working with Treasury Board Secretariat and the Department of Supply and Services to implement criteria for financial system development in departments and agencies.

31. In response to the serious inadequacies in financial systems development, the Auditor General made a number of government-wide recommendations.

32. **Your Committee endorses the following recommendations of the Auditor General and calls upon Treasury Board Secretariat and the Office of the Comptroller General to monitor departments' implementation of corrective measures:**

(a) **departments should apply appropriate systems development management processes and enforce them rigorously;**

(b) **systems development should be pursued through relatively small project stages with short time frames, clearly defined objectives and detailed budgets;**

(c) **all systems development costs should be recorded and compared to systems development budgets on a year-to-date and on a cumulative basis to provide an accurate record of total costs; and**

(d) **departments should use appropriate project management techniques to monitor developments and track benefits on a regular basis.**

C. Role of the Financial Function

33. Your Committee is concerned with the adequacy of the role of financial officers, including senior financial officers, in departments and agencies. Financial officers perform a variety of tasks but are often not really part of management decisions. The Auditor General has concluded that, in many instances, the financial function does not provide the necessary direction and guidance to promote the use of measures of economy, efficiency and effectiveness.

34. In the Department of Supply and Services, your Committee noted that financial systems and planning processes had been reviewed and that the Department was aware of the need for greater cost-consciousness in its line managers. These measures involved a prominent role for financial officers in the Department.

35. Financial officers can bring objective information and advice to senior management in resource allocation, for capital projects, or any other major spending decisions. In the Department of Transport, a program control board provided a formal corporate challenge to spending decisions. In the Department of Energy, Mines and Resources, a management review process initiated a comprehensive study of departmental spending priorities. Your Committee considers that senior financial officers need to be involved in policy development and resource allocation in all departments and agencies, as an integral part of the financial function and to ensure greater economy and efficiency in government spending.

Recommendation

36. Your Committee recommends that all government departments and agencies include the senior financial officer as an integral part of the decision-making process so that decisions are demonstrably based on cost-benefit analysis and improved reporting of costs.

D. Efficiency, Productivity and Cost Savings

37. Your Committee noted the Auditor General's finding that, with few exceptions, information on the efficiency of departments' operations is inadequate to support resource allocation or to ensure the efficient management of available resources. In the absence of efficiency and productivity measures, opportunities for cost savings may be lost because departments do not know their present productivity level as compared with attainable targets for improvement.

38. For example, in the Department of Supply and Services your Committee noted that the Department did not have cost information to enable a comparison of its productivity with that of its provincial counterparts. The Auditor General undertook such a comparison and found that the Department's costs were two to three times higher than that of the provinces.

This represented a difference of up to $46 million per year. Elsewhere in the Department, the Auditor General estimated attainable productivity gains in the range of 5 to 9 per cent for further savings of $3.5 million to $6.5 million annually. While the Department questioned the accuracy of these estimates, they were unable to come up with their own figures.

39. In other departments, your Committee noted opportunities for cost savings arising from improvements in financial management. For example, in the Department of National Health and Welfare, savings of approximately $50 million could be achieved through the implementation of a more modern system for the delivery of income security benefit payments.

40. Your Committee also noted various measures taken by some departments to reduce expenditures by down-sizing. For reductions in person-years to result in cost savings, the process must be managed fairly and with demonstrated concern and assistance for affected employees so that staff morale does not suffer. Resourceful and involved staff can use the opportunity of down-sizing to find new and more efficient ways of managing. For example, in order to meet its person-year reduction targets, the Department of Supply and Services undertook a study of productivity improvement opportunities. This study resulted in a number of initiatives which have become part of the Department's resource allocation process.

41. Your Committee noted that there is ample opportunity for the improvement of productivity across government. In 1979, the Auditor General found low efficiency rates in some departments' clerical operations. He stated that if these rates could be extended to all of the Public Service, there would be potential economies in payroll costs of approximately $200 million which represented a possible cost improvement equal to as much as $35 a year for each Canadian taxpayer. In other words, substantial annual savings could be realized through higher levels of productivity. The measurement of efficiency through the development of information-oriented systems would also assist the IMAA process by providing additional indicators of departmental performance. Your Committee considers that all departments and agencies need to adopt measurement plans to assess productivity and provide sound basis for improving the efficiency of operations.

Recommendation

42. Your Committee recommends that the Government instruct all departments and agencies to design and implement productivity measurement plans and report progress in doing so by March 31, 1989.

43. Your Committee requests that the Government table a comprehensive response to the recommendations contained in this Report in accordance with Standing Order 99(2).

44. A copy of the relevant Minutes of Proceedings and Evidence *(Issues Nos. 30, 31, 32, 33, 34, 35, 36, 38, 39 and 40 which includes this Report)* is tabled.

Respectfully submitted,

AIDEEN NICHOLSON
Chairman

REPORT TO THE HOUSE

Wednesday, 27 July 1988

The Standing Committee on Public Accounts has the honour to present its

FIFTEENTH REPORT

In accordance with its mandate under Standing Order 96(3)(f), your Committee has considered the Report of the Auditor General to the House of Commons and the Public Accounts of Canada for the fiscal year ended March 31, 1987 and is pleased to present its second annual report to the House on its activities over the past year.

Throughout the year and in this report, the Committee's focus has been on the management of expenditures, making recommendations to improve practices and procedures at the front end of the expenditure process, before public funds are committed. In its 12th Report to the House (tabled May 4, 1988) the Committee proposed a budget committee to enhance Parliamentary control over the Estimates. The focus in your Committee's report on the Financial Management and Control Study has been the improvement of financial management so that managers know the financial implications of their decisions and operations are carried out with due regard to economy, efficiency and effectiveness. Your Committee's concern was that policy decisions are being taken without good information on costs and without full knowledge of the implications of these decisions. Considerable progress has been made in financial control, which is the proper recording and protecting of government assets, ensuring that funds are spent only for the purposes approved by Parliament.

Other developments during the year have included continued significant savings from improved cash management by government departments and agencies (related to the Committee's 4th Report of May 1985) and the adoption of procedures to better report on remission orders (1st Report, November 1986). The Committee also studied the operations of its counterparts in the Netherlands, West Germany and Sweden; the findings influenced the recommendations for the budget committee.

In this annual report, your Committee presents a summary of its activities over the year. Information is presented on the following matters:

A. Significant developments during the year, including an account of reports tabled in the House;
B. Follow-up on earlier committee reports; and
C. Topics raised in the evidence but not separately reported on.

A. DEVELOPMENTS DURING THE YEAR

Budget Committee

The need for a budget committee to scrutinize government spending proposals was a major conclusion of your Committee over the past year (12th Report, May 4, 1988).

Such a committee would be composed of members of the Public Accounts Committee and members of appropriate standing committees and would examine the Estimates with a focus on departmental budgets as opposed to the policy orientation of the existing standing committees.

Members of standing committees have developed considerable knowledge of departmental policies and programs. When considering Estimates, these committees have tended to focus attention on policy matters and are quite successful at highlighting concerns in these areas. However, there remains a gap in the review of government expenditures because standing committees do not study Estimates line by line. In addition, each department's spending is looked at in isolation without consideration of government-wide trends.

What is needed is a budget committee whose review of expenditures before the fact will parallel that of the Public Accounts Committee's review after the fact. Each year the Public Accounts Committee examines the report of Parliament's auditor, the Auditor General. Major findings of the Auditor General are subjected to detailed scrutiny and the Committee encourages public officials to improve the quality of management and of accountability to the taxpayer. Similarly, a budget committee would compare and assess each department's need for funds and look at overall trends in public spending.

To develop the budget committee proposal, further study is needed. Your Committee will therefore undertake an examination of the pertinent reports and studies on this subject over the coming months with a view to preparing a detailed report to the House by the fall of this year. Among the issues to be considered is the relaxation of the non-confidence convention as it applies to the proposed budget committee. There is a need to seek a balance between the Government's present control over the supply process and the need for Parliamentarians to better exercise their age-old power to vote supply. The terms of reference for the Committee's study will also include: the form and substance of the Estimates; the procedures for the review of the Estimates; the mandate, powers, and membership of the proposed budget committee established to consider the Estimates; the principle of ministerial responsibility and accountability for departmental operations; and the connection between the supply process and the ways and means process.

Cash Management

Over the past year, the federal Public Service has reported continued significant improvements in cash management. Since the tabling of your Committee's report on this subject (May 22, 1985), over $539 million has been saved.

As a result of your Committee's report, business-like practices have been adopted in the way government makes payments, collects accounts receivable, deposits its receipts and considers financing costs in its financial decisions. For example, improved collection of accounts receivable resulted in a gain of $46 million in 1985-86 and $16 million in 1986-87, while enhanced recoveries of cash from Crown corporations netted $365 million and $54 million in the same years.

Indian Affairs

When your Committee reported on the Department of Indian Affairs and Northern Development (4th Report, March 9, 1987), one of the major concerns was inadequate procedures in the management of Indian lands, estates and moneys. In areas such as the processing of estates and the release of funds from trust accounts for minors, the Department did not meet professional standards. Your Committee called for the introduction of amendments to the Indian Act to alleviate some of these concerns.

Your Committee noted that action has been taken with respect to some of the areas of needed amendment in the Indian Act. On June 2, 1988, the House gave second reading to Bill C-123 which amends the Indian Act concerning minors' trust accounts and a spouse's preferential share of an estate when a person dies without a will.

Remission Programs

In its First Report (November 4, 1986) your Committee considered income tax remissions orders. In a hearing with Revenue Canada (Customs and Excise), your Committee also considered remission programs applicable to customs duties and excise taxes. Remissions of tax or duty usually provide relief to the taxpayer from some aspect of the tax system and are sometimes used to implement a particular policy. One major concern of your Committee was the failure to provide adequate information to Parliament on remission orders, which have become a major tax expenditure totalling approximately $1 billion in 1985-86.

Over the past year, the Minister of Finance has responded positively to some of your Committee's concerns. All remission orders above $20 million in value are now tabled in Parliament and semi-annual reports to Parliament on remission orders are also tabled, indicating, for each remission order, the total amount involved and the reasons for the order. In addition, improvements will be made in the reporting of remission orders in the Public Accounts of Canada. As a result of the above measures, both Parliament and the public are now better informed.

Committee Reports

(a) Income Tax Expenditures

In its report on income tax expenditures (11th Report, November 2, 1987), your Committee focused on the need for improved information to Parliament and the implementation of sound monitoring and evaluation procedures by the Department of Finance.

With respect to information for Parliament, your Committee considered that improvements were required both in the quality of tax expenditure information and in the process whereby such information is provided to Parliament. All major tax expenditures should be subjected to an open process of consultation prior to their introduction with ample opportunity for Parliamentary review. In addition, an annual account of tax expenditures should be tabled in Parliament.

Your Committee raised a number of basic questions about the process whereby tax expenditure programs are approved and managed. These questions were related to program evaluation and a new evaluation unit recently established by the Department of Finance may help to answer them. Your Committee has called upon the Department to give priority to the evaluation of higher risk programs. Your Committee will monitor the progress of the Department's program evaluation branch.

(b) Financial Management and Control Study

The Committee's report on the Financial Management and Control Study (FMCS) centred on weak financial management in government departments and agencies. Policy decisions are being made without adequate financial information that decision-makers need to understand the implications of their decisions. There is an enormous lack of cost information across government. The taxpayer cannot be assured that operations in the public service are being carried out with due regard to economy, efficiency and effectiveness.

Financial accountability, ensuring that managers account for the resources entrusted to them, means a chain of accountability, from departmental managers to Treasury Board and from both of these to Parliament. Your Committee encouraged a new procedure to improve financial accountability of departments. Increased Ministerial Authority and Accountability, which will assign greater responsibilities to departmental management in return for enhanced reporting of performance. It will require managers to manage and replace the sometimes illusory control exercised by Treasury Board. At the same time, your Committee insisted that Treasury Board not abdicate its statutory responsibilities for the management of public funds.

Your Committee continues to be concerned about serious inadequacies in financial computer systems. Your Committee found a pattern of project failures, cost overruns, poor operating performance, duplication of effort and significant waste. To remedy these deficiencies, your Committee endorsed the Auditor General's recommendations in this area and called upon Treasury Board Secretariat and the Office of the Comptroller General to monitor departments' implementation of corrective measures.

Your Committee called for the senior financial officer to be an integral part of departments' decision-making process so that decisions are demonstrably based on cost-benefit analysis and improved reporting of costs. Your Committee further recommended that all departments and agencies implement productivity measurement plans.

B. FOLLOW-UP ON COMMITTEE REPORTS

The follow-up process is an integral part of the relationship between the Committee and government departments and agencies. As the audit committee of Parliament, the Committee is concerned with the nature and extent of the remedial actions in response to its recommendations. The process usually involves the submission of progress reports and the assessment of these by the Auditor General.

Department of Public Works (2nd Report, December 18, 1986)

Your Committee sought updates from the Department of Public Works in a number of areas, notably the implementation of revenue dependency, a system to improve cost-effectiveness by charging client departments for services. Other areas reported to your Committee involved the need for improvements in planning the accommodation of government departments, in the extent of competitive tendering, in financial management systems, and in the rationalization of architectural and engineering services. The Auditor General assessed these responses on behalf of your Committee. In most areas progress was noted. For example, revenue dependency has been implemented on the services side of the Department but not on the accommodation side and a full financial management system is not yet in place, although important components are. Your Committee will continue to monitor the Department's progress.

Department of Indian Affairs and Northern Development (4th and 5th Reports, March 9 and 16, 1987)

Further responses were received in the past year from the Department of Indian Affairs and Northern Development relating to the management of Indian lands and moneys, contributions to Indian bands and procedures for native claims settlements. These responses were assessed by the Auditor General. In the case of Indian lands and moneys, the Department made specific undertakings to your Committee for remedial action and firm target dates for the completion of these measures have now been set. With respect to contributions to Indian bands, efforts are underway to improve controls over payments and implement alternative funding arrangements. The Department will continue to report its progress to your Committee.

Department of External Affairs (6th Report, May 20, 1987)

The Department of External Affairs has responded to your Committee's recommendations and these responses have been assessed by the Auditor General. In a number of key areas, such as personnel policy and improved operating relationships with other government departments, the department has made progress in implementing your Committee's recommendations. In other areas, such as the establishment of levels of service at posts abroad, the Department's remedial actions have been incomplete, based on differing views as to the need for the measures recommended by the Auditor General and your Committee.

Department of Agriculture (7th Report, June 11, 1987)

During the past year, the Department of Agriculture responded to your Committee's recommendations by providing a detailed progress report and other documentation related to the recommendations of the Auditor General. Your Committee noted that the Department's response included a timetable of planned corrective measures for those recommendations where remedial action was incomplete. The Department appeared to have taken action in many of the areas of concern to your Committee, such as improved management of the Department's research operations and the adoption of improved procedures for the handling and disposal of toxic wastes and hazardous materials.

C. TOPICS RAISED IN THE EVIDENCE

Over the past year, your Committee heard evidence on the following matters which were not separately reported to the House:

(i) payment of public funds to a Hong Kong bank in a manner that appeared to avoid Canadian income taxes;

(ii) overexpended appropriations in seven departments;

(iii) materiel support and major capital projects in the Department of National Defence;

(iv) public pensions management, Indian and Northern health care, and the backlog in the approval of drug submissions in the Department of National Health and Welfare;

(v) the Auditor General's 1988-89 Estimates; and

(vi) the Canadian Jobs Strategy in the Canada Employment and Immigration Commission.

Your Committee wishes to summarize its major observations and conclusions with respect to several of these subjects.

Overexpended Appropriations

Your Committee noted ten instances in seven departments of overexpended appropriations for the 1986-87 fiscal year. the most significant overexpended appropriation was in the Department of Regional Industrial Expansion (DRIE), where approximately $80 million was overspent. Your Committee noted that the Department has responded with more rigorous systems and procedures for forecasting, budgeting and financial control. An important part of the problem is that the Department, which has multi-year spending commitments, needs to know what its commitments are at all times and your Committee considers that the systems introduced in the Department must serve that objective. This situation reinforces your Committee's emphasis in this annual report on the need for better controls before public funds are spent.

National Defence

With respect to materiel support, your Committee shared the Auditor General's concern that neither the materiel support system nor the logistics framework of the Canadian Armed Forces was suitably developed for sustained conflict. The supply system was based on 1960s technology and although work had started on a replacement system, the new system would not be in place before 1995. Other issues of concern to your Committee were the annual purchasing of $35 million worth of supplies in advance of need, the failure to observe due regard for economy in purchasing, and $300 million worth of excess inventory. Your Committee also concluded that the Departments of National Defence and Supply and Services should tighten up procedures related to the purchase of foreign-sourced material through Canadian middlemen where the latter were making excessive profits.

In relation to major capital projects, your Committee found that the systems and practices used by the Department to manage these projects were generally appropriate. However, your Committee was concerned by the need to better define what constituted a major capital project. In one case, a $40 million component was removed from a contract in order to avoid the more stringent criteria for Treasury Board approval applicable to a major Crown project. Another concern of your committee was the sole-sourcing of major contracts. For example, a contract valued in excess of $1 billion was entered into without competitive bids and the Auditor General could not find evidence of the reasoning behind the sole-sourcing decision in the files.

National Health and Welfare

Your Committee was concerned by the need to implement measures of performance and improve productivity in the Canada Pension Plan and Old Age Security programs. Processing times of pensions, including disability pensions, are excessively long and have not improved appreciably since the Auditor General's last audit two years ago. The Department indicated to your Committee that improved procedures would streamline the processing of applications. Your Committee expects the Department to implement these measures.

Another subject considered by your Committee was the adequacy of Indian and Northern health services. The Auditor General concluded that existing systems were so deficient that the Department could not be sure it was delivering an adequate level of health services to these individuals. In response to these deficiencies, the Department made a commitment to your Committee to improve its planning and management systems, notably in relation to programs such as the National Native Alcohol and Drug Abuse Program.

Your Committee was also concerned by the delays and significant backlog in the approval of new drug submissions by the Department of National Health and Welfare. Canadians must wait up to two years for a new drug to enter the marketplace. The Department informed your Committee that it would implement productivity targets and guidelines to require more complete applications from drug manufacturers.

Auditor General's Estimates

Your Committee considered the Auditor General's 1988-89 Main Estimates. Among the issues discussed were the need for 28 additional person-years and the international activities of the Audit Office. The Auditor General provided your Committee with an explanation of his increase in person-year utilization and described in some detail the long-standing involvement of that office in international matters such as the United Nations audit. In addition, your Committee held a second meeting in camera to discuss the subjects proposed for the Auditor General's 1989 Annual report.

Canadian Jobs Strategy

The Canadian Jobs Strategy embodied six major federal labour market programs and was launched in a very short period over the summer of 1985. Among your Committee's concerns with respect to the Strategy was the failure to carry out a formal financial analysis of alternative programs. There were also inadequacies in forms, guidelines and directives leading to incomplete files for 40 per cent of proposal approvals. the Canada Employment and Immigration Commission informed your Committee that a departmental task force had been created to respond to these problems. The Commission made a commitment to your Committee that improvements would be made through changes in programming criteria, new support procedures, and an extensive staff training program.

A copy of the relevant Minutes of Proceedings and Evidence (*Issues Nos. 27, 28, 29, 35, 37, 39 and 41 which includes this Report*) is tabled.

Respectfully submitted,

AIDEEN NICHOLSON
Chairman

APPENDIX D

REPORT TO THE SENATE OF THE STANDING SENATE COMMITTEE ON NATIONAL FINANCE

REPORT TO THE SENATE

Tuesday, 15 March 1988

The Standing Senate Committee on National Finance has the honour to present its

EIGHTEENTH REPORT

Your Committee to which the expenditures proposed by the Estimates for this fiscal year ending 31 March 1988 were referred, examined the said Estimates and presents, in obedience to the Order of Reference of 10 March 1987, its final report as follows:

The Standing Senate Committee on National Finance has periodically raised questions regarding the concept of comprehensive auditing. Last fall it was the Committee's decision to review this matter by inviting the following witnesses:

Professor Sharon Sutherland
Carleton University

Mr. G. Cowperthwaite and Mr. J.P. Boisclair
Canadian Comprehensive Auditing Foundation

Mr. B. Caine and Mr. J. Kelly
Canadian Institute of Chartered Accountants

Mr. K. Dye
Auditor General of Canada

Mr. A. Macdonald
Comptroller General of Canada

The purpose of these hearings was to understand the complexities of comprehensive auditing and, if possible, to draw conclusions and recommendations for both the practitioners and the users of this process.

This report is divided into four sections. The first section describes the purpose of comprehensive auditing; the second describes the areas the Committee examined; the third focusses on issues of special importance that surfaced and includes the conclusions and recommendations; and the fourth summarizes the Committee's findings.

I THE PURPOSE OF COMPREHENSIVE AUDITING

In the simplest terms, comprehensive auditing is concerned with accountability. Legislatures provide authority to governments to collect revenues and to make expenditures. In so doing, legislatures have a responsibility to oversee the administration of the acquisition and use of public resources. This means that governments are accountable to their legislatures which in turn are accountable to their electorate.

To fulfil this responsibility, legislatures require a regular accounting from their governments of the collection and the use of these public resources. Comprehensive auditing is a broad spectrum procedure for providing legislatures with assessments of administrative procedures and practices, as well as providing opinions on the credibility of management reports. To accomplish this, practitioners of comprehensive auditing engage in three tasks:

1. attesting to the financial statements of the government;
2. auditing for compliance with legislative authorities; and
3. auditing for value-for-money.

The first two, financial attesting and legislative compliance are normal, traditional, and accepted activities of any legislative auditor. Mr. Kenneth Dye, the Auditor General of Canada in his opening remarks, recounted to the Committee that since 1878, auditors general in Canada have been reporting to the House of Commons on the legality of expenditures and the arithmetic of the public accounts. He also pointed out that these same legislative auditors have periodically reported on instances of waste, extravagance, or unproductive use of public resources. It was in the 1970's, based upon the recommendations of the Report of the Independent Review Committee on the Office of the Auditor General (Wilson Report), that a consensus was reached that value-for-money auditing should be made a formal responsibility of the Auditor General of Canada. This was incorporated into the Auditor General Act in 1977.

The generally accepted elements of value-for-money auditing are economy, efficiency and effectiveness. In the reports of the Canadian Institute of Chartered Accountants (CICA), Value-for-Money Auditing Standards, these three elements are defined as follows:

- "Economy" refers to the *acquisition* of the appropriate quality and quantity of financial, human and physical resources at the appropriate times and at the lowest cost.
- "Efficiency" refers to the productive *use* of financial, human and physical resources – i.e., maximizing output for any given set of resource inputs, or minimizing inputs for any given quantity and quality of service provided.
- "Effectiveness" refers to the *achievement* of the objectives or other intended effects of a program, an operation or an activity.

The authority of the Auditor General to review government spending in the context of the above three tasks, along with financial attesting and legislative compliance, are spelled out in section 7(2) of the Auditor General Act, 1977. This section gives the Auditor General responsibility to report on economy and efficiency, but limits his role on effectiveness, to reporting on instances where satisfactory procedures are not in place to demonstrate it. (Sections 5, 6, 7 and 8, which define the Auditor General's responsibilities, are reprinted in the appendix of this report.)

II ISSUES EXAMINED

In gaining an appreciation of the complexities of comprehensive auditing, and in particular, value-for-money auditing, the Committee focussed on three general issues.

The first of these was the burden of responsibility for keeping Parliament informed about the effectiveness, efficiency and economy in government. There is a clear understanding that with respect to the financial accounts of government, it is management's responsibility to maintain the books in accordance with accepted accounting standards.

The role of the legislative auditor is to examine the books and to report annually as to whether management has presented fairly the accounts of the enterprise. This is the same kind of statement that appears with every annual report of every public or private enterprise in Canada.

There is also a clear understanding that with respect to legislative compliance, it is the legislative auditor who reports to his legislature that the enterprise operates within the laws of the land and within any specific legislation that applies to that enterprise. For example within the Government of Canada, the Financial Administration Act sets down a number of requirements for the receipt and disbursement of public money. While public servants are expected to comply with this Act, it is the Auditor General who is required to report upon any breach of the law.

But with respect to value-for-money reporting, there are no such understanding. In the private sector, the final check on the economy, efficiency and effectiveness of the enterprise is profitability. Auditors are not called upon to comment publicly on anything that might affect this profitability. That is not to say that boards of directors or their audit committees do not call upon their outside auditors to comment on anything untoward, but this is normally done in confidence, and is not part of the usual obligations of the auditors. For the federal government, the fact that the Auditor General has the authority to report on value-for-money does not alleviate management's responsibility from also reporting. This general area of the relative responsibilities of both the legislative auditor and of management was the first issue discussed at these hearings.

The second general issue on the Committee's agenda was whether current information on value-for-money is presented in the most appropriate vehicle. All parliamentarians and most watchers of government are familiar with the annual reports of the Auditor General. These reports are poured over by some members of the press as well as by opposition critics in Parliament in the hope of finding examples of uneconomic, inefficient or ineffective use of public money.

But there are however, other sources of information on value-for-money. Such sources include reports of parliamentary committees, testimonies before these committees by ministers and public servants, annual reports of programs and ministries, and the Part III's of the Estimates. The usefulness and appropriateness of these formed the second issue for discussion.

The third general issue was the limits to the responsibilities of the Auditor General of Canada in value-for-money auditing. While the Auditor General Act, 1977 clearly gives him responsibility to report to House of Commons on value-for-money, and hopefully one day to all of Parliament, there is common agreement that this does not include a review of the merits of policy. But, there is no common agreement as to where the setting of policy ends and the administration of it begins.

III AREAS OF SPECIAL IMPORTANCE

The examination of the three general issues described in the previous section illuminated five areas of special importance. Each of these areas are described in this section with the Committee's conclusion and recommendations.

Defining Effectiveness

In the Value-for-Money Auditing Standards the CICA, provides a narrow definition of effectiveness which stresses the extent to which a program achieves its goals and other intended effects (this is quoted earlier in this text). But Mr. Cowperthwaite and Mr. Boisclair of the Canadian Comprehensive Auditing Foundation (CCAF) stressed that effectiveness, broadly defined, should be about performance in general, and as such, is much more pervasive than simply the attainment of program goals. The CCAF summary report Effectiveness indicates that this is only one among a number of critical factors such as economy and efficiency that are essential to a meaningful understanding of broad-based effectiveness. However Canadian legislation and practice defines effectiveness narrowly and tends to make sharp distinctions between economy and efficiency on the one hand, and effectiveness on the other. The Part III's of the Estimates illustrate this distinction. For example, in the Part III for Environment Canada, the Park Canada service refers to its criteria for measuring effectiveness as the protection of Canada's heritage and the presentation of it to the public. (See Environment Canada's Estimates 1987-88, Part III (p. 4-21)). Five pages later there is a totally separate section on program performance and resource justification.

The Committee prefers this broad-based definition of effectiveness and believes that it makes little sense to separate resource justification and program performance from effectiveness. Yet members expressed understanding for the difficulty in trying to define the attributes of effectiveness. It cannot be limited to measuring solely the extent to which a program meets its objectives. Nor can effectiveness be measured independent of costs and productivity. Evaluators, whether they are accountants, social scientists, engineers or other kinds of professionals will have to bear in mind the "softness" on any meaningful definition of effectiveness. Those who look for neat pigeon holes in which to categorize effectiveness will always be open to the criticism of incompleteness and inadequacy.

In this previous discussion illustrating the difficulty in defining broad-based effectiveness, we have focussed on the practitioners. The clients of these practitioners within government are deputy ministers, and in some cases, ministers. The Auditor General sees his client as the House of Commons. But whether the client is government or Parliament, it is different from the stakeholder – the recipient of the benefits of the program or activities. When defining criteria for effectiveness, the perceptions of the stakeholder may be different from those of the client. While there is no doubt that those who establish criteria for measuring effectiveness do not intentionally avoid the pressing concerns of the stakeholder, the results, however, may be the same. In the Ontario Royal Commission Report Equality in Employment, the commissioner, Judge Rosalie Abella, stated that:

> "It is sometimes exceptionally difficult to determine whether or not someone intends to discriminate ...
>
> The impact of behaviour is the essence of "systemic discrimination". It suggests that the inexorable, cumulative effect on individuals or groups, of behaviour that has an arbitrarily negative impact on them, is more significant than whether the behaviour flows from insensitivity or intentional discrimination." (p. 9)

In measuring effectiveness, this unintentional avoidance of the concerns of the stakeholders may lead to misleading results, or in some cases, significantly perverse conclusions. To overcome this potential problem, particularly in programs that do not cater to recipients with middle-class values, or as Judge Abella observed, "white able–bodied males' perceptions of everybody else", some committee members felt that the element of equity should be considered when establishing criteria for economy, efficiency and effectiveness. The Committee realized in proposing this that the life of evaluators and auditors will not be made easy, but these evaluators must recognize that value-for-money auditing is not a precise science and that it requires subjective decision-making.

Responsibility for Reporting on Value-for-Money

All the witnesses who appeared before the Committee agreed that government managers have the principle responsibility to report on value-for-money which is synonymous with broad-based effectiveness. Consistent with this was the view that the ideal role of the Auditor General should be to provide opinions about the fairness of this reporting. In effect, the same process used for financial disclosure should be used for value-for-money reporting. The Committee was in full agreement with this basis principle but recognized that putting it into practice was more difficult because of many kinds of problems. For example, limiting the Auditor General to attesting to the reports of management is too constraining. There may be cases which he or Parliament feel should be investigated and this mandate should not prevent him from doing so. But these should be the exception rather than the rule. Also some programs or activities lend themselves to reporting on value-for-money; these include programs with specific clients, like the Printing Bureau of Supply and Services. Others like the establishing and maintaining of embassies abroad function of External Affairs is not so easily evaluated. Activities which cut across the responsibilities of many government departments are also difficult to establish evaluation criteria and to evaluate. Some, like the employment equity activity have a centrally located responsibility centre like Treasury Board. But other activities, like fostering high quality research in Canada is being delivered by many departments, often with competing objectives. Mr. Macdonald, the acting Comptroller General summarized this:

> "When you have a government department that is more like the conventional private sector model of a production process, you are more likely to find the kinds of indicators and performance measures that facilitate a more precise definition. However, as you move into the area of competing objectives and shaping and influencing, - which are legitimate roles of government - it becomes significantly more difficult."

The prevailing view in the Committee is that management is responsible for reporting on value-for-money. It is also the prevailing view that the Part III's of the Estimates are the most appropriate vehicle for reporting on the results of these evaluations. In spite of this the Committee was well aware that this would leave gaps in activities which are horizontal and cut across departmental lines leaving no one responsible. Such instances where there is no obvious client should be pointed out by the Auditor General.

If there is no obvious client, the Comptroller General might have to be that person. This is not in keeping with the usual function of the Office of the Comptroller General of Canada which operates as an arm of Treasury Board. Those functions for the most part, are advisory particularly in providing policy guidance to departments and agencies on financial management, in developing related methodologies and in assisting departments in interpreting and complying with these policies.

While the Part III's are already used to report on value-for-money, the Committee wishes to stress that this reporting is inconsistent. For improvements to take place the initiative must come from Parliament rather than from the bureaucracy. Mr. Macdonald stated "if you go to a committee four years in a row and no one asks a question about the Part III, it is difficult to convince a minister or deputy minister to improve it." In this regard, the Committee is very pleased to learn that the Auditor General is engaged in a government-wide audit of the Part III's including a review of the performance related information. When the Auditor General tables this report, the Committee intends to invite him to speak to it.

Finally, the Committee wishes to note that it is aware that this principle of management reporting on broad-based effectiveness and auditors attesting to the fairness of these reports is the ideal, but long-term goal. In reality, the Committee believes that while achieving this is some way off, it nevertheless should remain the optimal target. Constant pressure from the Comptroller General, the Auditor General, and from committees of Parliament can speed up the process.

Mandate of the Auditor General of Canada

We have already discussed elsewhere in this report the responsibilities of the Auditor General as defined in the Auditor General Act, 1977. While this Act says nothing about the policy role of the Auditor General, there is a clear understanding that his office does not judge the merits of policy. Mr. Dye was categorical that auditing government policy is the responsibility and prerogative of Parliament only.

This avoidance of policy issues of any federal legislative auditor is much more explicit with respect to Crown corporations. Section 147 of the Financial Administration Act specifies:

> "Nothing in this Part (Part XII) or the regulations shall be construed as authorizing the auditor or examiner of a Crown corporation to express any opinion on the merits of matters of policy, including the merits of:
>
> *(a)* the objects or purposes for which the corporation is incorporated, or the restrictions on the businesses or activities that it may carry on, as set out in its charter;
>
> *(b)* the objectives of the corporations; and
>
> *(c)* any business or policy decision of the corporation or of the Government of Canada."

The problem is not that the Auditor General should avoid policy issues, but where does policy and administration begin. Members of the Committee took up this matter with every witness. The most frequently used example was the constitutional requirement for maintaining a transportation link between Prince Edward Island and the mainland. It was acknowledged that the policy is to maintain a transportation link, but whether the various means for providing the link can be compared in terms of value-for-money was questioned. Deciding which of the alternatives provides the best value-for-money, ferry, bridge or tunnel, causes many policy issues to come into play in addition to the policy of providing the transportation link. These include concerns for employment, regional development, tourism, environment, fishing and others. In light of policies in these various areas, the most economic may not be the best. It may be that Cabinet will have to chose the type of link and leave to the auditors the role of ensuring that whichever means is chosen, the link will be constructed with due regard for value-for-money.

Professor Sharon Sutherland from Carleton University drew an even finer distinction in defining the limits of policy for audit purposes. She stated:

> "I find most alarming the statement that the auditor will give the government decision-makers assurance that advice coming up to decision-makers adequately addressed effectiveness guidelines which, however, are not specified. This brings the auditor right smack into the middle of the advice stream. Despite the assurance that this kind of audit cannot tread on policy concerns, this kind of audit is a monitoring of the advice that goes into the making of policy; it is an upstream monitoring. So all the assurances about keeping out of policy are not meaningful. This kind of role of seeing whether the device that has gone up to decision makers is good advice belongs to the Treasury Board Secretariat and the central agencies of government." (Proceedings of the Standing Committee on National Finance, January 28, 1988, p. 21:19)

This matter of the legitimacy of the role of the Auditor General in auditing the quality of advice going to Cabinet is the kind of issue which finds the Auditor General and the government on opposite sides of the Petrofina case currently before the Supreme Court of Canada.

In the end, members of the Committee and witnesses were in full agreement that deciding upon the limits of policy considerations can often be a very grey area. The Committee recognized that even if the Auditor General's ideal role is largely confined to attesting to the fairness of management representations on value-for-money, his role will continue to grow during the foreseeable future because of the unclear limits to the area of his responsibilities.

This possibility places him in an increasingly sensitive and complex position and most particularly as the decision as to what he is to report upon is his exclusive jurisdiction.

The Committee acknowledged that the Auditor General has a panel of senior advisers made up of senior members of accounting and management consulting firms in Canada and it is their role to advise him on whatever issues he chooses to bring before them. The Committee notes, however, that all these members are accountants or management consultants and that because broad-based effectiveness auditing requires a much wider expertise, outstanding Canadians knowledgeable of the complexities of policy, regardless of their background, should be sought for their wisdom.

The Auditor General and his staff in conjunction with program managers also have a significant responsibility in specifying the criteria to be used in undertaking value-for-money audits or attesting to their fairness. The Financial Administration Act is again useful in guiding how these criteria should be established. Section 143(3) and (4) indicates that the criteria to be applied must be submitted to the board of directors or to its audit committee for approval. In the event of a disagreement, it is the minister or a parent Crown corporation that arbitrates this matter.

Alternatively, the CICA Value-For-Money Auditing Standards indicate that an auditor should use management established criteria, if he is in agreement. If he believes that management's criteria are not suitable and he cannot resolve any differences of opinion, the auditor should select his own suitable criteria or limit the scope of the examination to those areas in which agreement can be reached.

The CICA's document and the Financial Administration Act place a different emphasis on the prime responsibility for establishing criteria for evaluations. The Committee raises this point because again it illustrates the sensitivity and subjectivity involved in value-for-money audits. It is a further example of this delicacy of the role of the Auditor General of Canada and the need for the best advice possible in fulfilling the role.

Relationship Between Value-for-Money and Legislative Compliance

Last fall, the committee examined the $80 million overexpenditure of the Department of Regional and Industrial Expansion (DRIE). Two observations concluded these hearings:

1. DRIE should improve its forecasting, budgeting and reporting, but that this should have been required of them years ago when it was first observed that DRIE's forecasts significantly exceeded its expenditure. It is the Committee's view that excessive lapses, that are not a result of due economy and efficiency, are as bad as overruns.

2. The Government of Canada should recognize that when programs are established to provide multi-year grants or contributions with uncertain timing as to when invoices would be received and pay outs made, it is impossible to avoid variable lapses and overruns and that the Payable at Year End policy is well designed to deal with them. (Proceedings of the Standing Committee on National Finance, October 22, 1987, p. 17.12.)

Because DRIE was working with many small clients who had uncertain timing in presenting their requests for money, the effectiveness of the program may not be consistent with annual appropriations and year-end lapses. This does not excuse a department for slipshod accounting, budgeting and forecasting, but it does constrain the ability of the department from pressing the objectives of the program to the fullest.

When the auditors who examined this overexpenditure reported, none of them commented on the possible incompatibility of the legislative requirement of annual budgeting and the program effectiveness influenced by uncertain timing for pay-outs. When the Comptroller General, Mr. Macdonald was asked whether it was compliance or effectiveness which took precedence, he indicated that while the answer is complex, in the end compliance must come first. Senators could understand this, but were nonetheless surprised that this issue had never been addressed directly in reports of Auditor General. The Committee wishes to remind the Auditor General, Comptroller General and Treasury Board that the possible incompatibility of legislative compliance and value-for-money may surface from time to time, particularly when program recipients do not follow established and regular annual patterns that governments are required to follow. It may be that the Auditor General should watch carefully for these potential conflicts and consider the circumstances such conflicts cause for program managers.

Periodic Reporting

In the previous section, the Committee commented on the possible incompatibility of a system of annual appropriations with some programs having uncertain, multi-year commitments. There are further complications related to program timing: government managers are already committed to a five-year cyclical review of all programs and activities of the government. While there is no requirement for management to report publicly on the results of these evaluations, it is becoming increasingly accepted that the annual reporting through the Part III's are a very appropriate reporting vehicle but this is an annual reporting process. In addition the Auditor General also is required by Section 7(1) of his Act to report annually on his comprehensive audit findings.

In the Committee's view, there is too much emphasis on annual reporting. While it is necessary for the Auditor General to examine and report annually on the financial accounting of the government, there is no practical need for him to report on the effectiveness of government programs and activities on the same annual basis. But for him to do otherwise might be difficult. Section 8 of his Act does allow him to make special reports on pressing matters that should not be deferred to his annual report. While value-for-money reporting may not have the same urgency, its shift to a periodic, non-annual basis, may reduce the clogging of the system and allow the Auditor General to report on the value-for-money activities of a program or activity on a more timely basis.

IV SUMMARY OF FINDINGS

In this final section, the Committee simply wishes to summarize the salient points raised under the five areas of special importance:

1. Defining Effectiveness

- effectiveness broadly defined, should be about performance in general and should mean much more than simply the extent to which program objectives are being met;
- federal legislation and practice defines effectiveness narrowly and tends to make sharp distinctions between economy and efficiency on the one hand, and effectiveness on the other;
- when defining the criteria for measuring broad-based effectiveness, the perceptions of the client (government and Parliament) may be different from those of the stakeholder (the program recipient);

- the unintentional avoidance of the concerns of the stakeholder may lead to misleading and possibly perverse conclusions about the effectiveness of programs;
- value-for-money and broad-based effectiveness are synonymous terms.

2. Responsibility for Reporting on Value-for-Money

- management should be the primary agent responsible to report to Parliament on value-for-money for its programs and activities;
- not all programs and activities easily lend themselves to value-for-money auditing and reporting;
- the Part III's of the Estimates are the most appropriate vehicle for management to report on value-for-money, but currently this reporting is inconsistent across departments.

3. Mandate of the Auditor General of Canada

- the ideal role of the Auditor General in value-for-money reporting should be to attest to the fairness of management reports, but his mandate should not prevent him from occasionally undertaking examinations of specific cases which he or Parliament feel should be reviewed;
- there is a clear understanding by the Auditor General of Canada that he does not review the merits of policy, but where policy ends and administration begins is a very grey area;
- selecting the criteria for value-for-money auditing is a sensitive area and can lead to conflicts between managers and auditors.

4. Relationships between Value-for-Money and Legislative Compliance

- when governments establish programs with objectives that foster multi-year financial commitments, but with uncertain timing, those objectives may not be consistent with a system of annual appropriations; in short achieving effectiveness may not be consistent with legislative compliance; and finally

5. Periodic Reporting

- reports by the Auditor General on value-for-money could be more timely if they were not required annually reporting.

In concluding this report, the Committee wishes to point out that it was not its intention to make strong recommendations to government or Parliament with respect to the current practices of comprehensive auditing. Rather the purpose was to expose the enormity and sensitivity of comprehensive auditing to its users and the responsibility this places on its practitioners.

Respectfully submitted,

FERNAND E. LEBLANC
Chairman

APPENDIX

AUDITOR GENERAL ACT
SECTIONS 5-8

5. The Auditor General is the auditor of the accounts of Canada, including those relating to the Consolidated Revenue Fund and as such shall make such examinations and inquiries as he considers necessary to enable him to report as required by this Act.

6. The Auditor General shall examine the several financial statements required by section 55 of the Financial Administration Act to be included in the Public Accounts, and any other statement that the President of the Treasury Board or the Minister of Finance may present for audit and shall express his opinion as to whether they present fairly information in accordance with stated accounting policies of the federal government and on a basis consistent with that of the preceding year together with any reservations he may have.

7.(1) The Auditor General shall report annually to the House of Commons

(a) on the work of his office; and,

(b) on whether, in carrying on the work of his office, he received all the information and explanations he required.

(2) Each report of the Auditor General under subsection (1) shall call attention to anything that he considers to be of significance and of a nature that should be brought to the attention of the House of Commons, including any cases in which he has observed that

(a) accounts have not been faithfully and properly maintained or public money has not been fully accounted for or paid, where so required by law, into the Consolidated Revenue Fund;

(b) essential records have not been maintained or the rules and procedures applied have been insufficient to safeguard and control public property, to secure an effective check on the assessment, collection and proper allocation of the revenue and to ensure that expenditures have been made only as authorized;

(c) money has been expended other than for purposes for which it was appropriated by Parliament;

(d) money has been expended without due regard to economy or efficiency; or

(e) satisfactory procedures have not been established to measure and report the effectiveness of programs, where such procedures could appropriately and reasonably be implemented.

(3) Each annual report by the Auditor General to the House of Commons shall be submitted to the Speaker of the House of Commons on or before the 31st day of December in the year to which the report relates and the speaker of the House of Commons shall lay each such report before the House of Commons forthwith after receipt thereof by him or, if that House is not then sitting, on the first day next thereafter that that House of Commons is sitting.

8.(1) The Auditor General may make a special report to the House of Commons on any matter of pressing importance or urgency that, in his opinion, should not be deferred until the presentation of his annual report.

(2) Each special report of the Auditor General to the House of Commons made under subsection (1) or 20(2) shall be submitted to the Speaker of the House of Commons and shall be laid before the House of Commons by the Speaker of the House of Commons forthwith after receipt thereof by him, or if that House is not then sitting, on the first day next thereafter that the House of Commons is sitting.

APPENDIX E

REPORT ON QUARTERLY REPORTS

REPORT ON THE AUDIT OF QUARTERLY REPORTS ON CROWN CORPORATIONS TABLED BY THE PRESIDENT OF THE TREASURY BOARD

Introduction. The Financial Administration Act requires the President of the Treasury Board to lay quarterly reports before each House of Parliament concerning the timing of tabling, by appropriate ministers, of annual reports and summaries of corporate plans and budgets of Crown corporations subject to the reporting provisions of Part XII of the Act.

These quarterly reports allow Parliament to hold the appropriate ministers (and, ultimately, the Crown corporations) accountable for providing it, within the relevant statutory deadlines, with information required under the Financial Administration Act. Accordingly, each quarterly report is required to indicate the annual reports and the summaries of corporate plans, capital budgets and operating budgets (and amendments to them) that were to be tabled before each House during the quarter; the time at, before, or within which they were required to be tabled; and the time they were actually tabled.

Scope. I am required by subsection 153.1(2) of the Financial Administration Act, to attest to the accuracy of the information contained in the quarterly reports on Crown corporations tabled by the President of the Treasury Board. Accordingly, I have examined the quarterly reports for the four quarters indicated below:

	Tabled in Parliament	
Quarter Ended	**House of Commons**	**Senate**
30 June 1987	10 September 1987	14 September 1987
30 September 1987	17 November 1987	18 November 1987
31 December 1987	2 March 1988	3 March 1988
31 March 1988	20 May 1988	24 May 1988

My examination included a review of the systems and procedures used by Treasury Board to monitor the tabling of the summaries and annual reports in each House of Parliament, a verification of the information contained in each of the quarterly reports, and such other tests and procedures as I considered necessary in the circumstances.

Conclusion. I have concluded that the four quarterly reports listed above contain all the required information about the timing of tabling, by the appropriate ministers, of Crown corporations' annual reports and summaries (and amendments to them) of corporate plans, capital budgets and operating budgets, and in my opinion, the information contained in the quarterly reports is accurate in all significant respects.

Kenneth M. Dye, F.C.A.
Auditor General of Canada

OTTAWA, 8 September 1988